DOCUMENT 2

# QUÉBEC AND ITS CHALLENGES

## POSSIBLE SOLUTIONS

## SPEND MORE EFFECTIVELY AND BETTER FUND OUR PUBLIC SERVICES

Advisory Committee
on the Economy
and Public Finances

Québec

**QUÉBEC AND ITS CHALLENGES - Document 2**
POSSIBLE SOLUTIONS
SPEND MORE EFFECTIVELY AND
BETTER FUND OUR PUBLIC SERVICES

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# FOREWORD

In December 2009, the Advisory Committee on the Economy and Public Finances published an initial document that examined the current state of Québec's public finances.[1] Pursuant to the process initiated by Minister of Finance Raymond Bachand, the committee is releasing a second document stemming from the second phase of its deliberations.

As the committee announced in the first document, the third and final document will be published between now and the tabling of the 2010-2011 Budget.[2]

The Advisory Committee comprises Pierre Fortin, Robert Gagné, Luc Godbout and Claude Montmarquette and is co-chaired by the Finance Minister and Robert Gagné.[3]

**Mandate of the Advisory Committee on the Economy and Public Finances**

Under the mandate that the Minister of Finance has assigned to it, the Advisory Committee on the Economy and Public Finances is being asked to:

- Propose an approach to implement measures aimed at ensuring a prompt return to sustainable economic growth and the funding of quality public services accessible to everyone.
- More specifically, in the economic sphere, the committee is being asked to:
  - Take stock of the initiatives to be emphasized and the appropriate approach to accelerate economic recovery and ensure that Québec is competitive and creates wealth in the medium and long terms, bearing in mind, in particular, the impact of demographic changes and the need to ensure that all regions benefit from economic development.
  - In this respect, it must also specify the means of enhancing productivity both in the private and public sectors.
- From the standpoint of public finances, the committee has a mandate to:
  - Take stock of priority initiatives and the appropriate approach to restore fiscal balance, anticipated in 2013-2014, and bolster public finances in the medium term, while:
    - ensuring funding for quality public services, especially in the health and education sectors;
    - enabling Québec to acquire adequate, updated infrastructure;
    - reducing for future generations the debt burden, which is already excessive;
    - obtaining the leeway necessary to ensure the development of the economy so that it remains competitive.

The committee will deliberate from November 2009 to February 2010, i.e. until the elaboration of the 2010-2011 Budget. The ministère des Finances will support the committee's deliberations.

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1 *Québec and Its Challenges, Document 1, Extensive public services, constrained leeway, and emerging challenges*, Advisory Committee on the Economy and Public Finances, December 2009, 60 pages.

2 *Ibid.*, page 7.

3 As indicated in the first document, the Minister's presence as co-chair of the committee in no way hampers its deliberations. The Minister will analyse the committee's proposals and discuss with his government colleagues the appropriate follow-up.

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# SUMMARY

The Advisory Committee on the Economy and Public Finances, established by the Minister of Finance in conjunction with the 2010-2011 prebudgetary consultation, comprises Pierre Fortin, Robert Gagné, Luc Godbout and Claude Montmarquette and is co-chaired by the Minister and Robert Gagné.[4]

The committee is pursuing the process initiated in November 2009. In the first document,[5] made public in December 2009, the committee defined the question that the Minister submitted to it by illustrating with concrete examples the current state of Québec's public finances and presenting a number of statistical observations.

In the second phase of its approach, the committee has decided to focus its reflection on two possible solutions pertaining to expenditures and the funding of public services.

## Can we spend more effectively?

The first part of this document is devoted to expenditures.

### ❑ The question is all the more crucial as we are spending heavily

Our level of spending is high and the basket of services that we offer is extensive. It is, therefore, crucial to ask ourselves if we can spend more effectively.

Elsewhere in the world, innovative, effective methods have gradually been contemplated and implemented in order to more effectively spend public funds. The methods have ensured that taxpayers obtain value for the money in relation to the taxes or fees that they pay. It is thus essential that Québec in turn undertake a sweeping change in its way of spending. The committee is convinced that Québec lags considerably behind a number of developed countries in respect of ways of spending public funds.

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4 The Minister's presence as co-chair of the committee in no way hampers its deliberations. The Minister will analyse the committee's proposals and discuss with his government colleagues the appropriate follow-up.

5 *Québec and Its Challenges, Document 1, Extensive public services, constrained leeway, and emerging challenges*, Advisory Committee on the Economy and Public Finances, Québec, December 2009, 60 pages.

In the past, controversy surrounding a possible calling into question of the basket of public services has overshadowed other recommendations pertaining to the reforms that we must make in our ways of spending. The committee has thus deliberately decided not to call into question at this juncture in its approach the basket of services that the Québec government offers in order to focus reflection on ways of spending.

## ❑ Public sector spending in Québec

In its examination of public sector spending in Québec, the committee has intentionally confined itself to a handful of sectors.

### ■ The health sector

The committee first focused on the health sector, whose scope and growth in spending devoted to it pose one of the key problems in public finances.

The first example that the committee chose concerns the **management structures of our healthcare system**.

— The management structures of our healthcare system are noteworthy for the very high degree of centralization of the decision-making process, which affects all levels of the management process.

— The Québec healthcare system juxtaposes an extensive central structure and a highly developed regional structure. This dual structure engenders an appreciable direct cost. Above all, it affects the system's operation, which it encumbers significantly. Generally speaking, the OECD countries have opted for a strong health ministry and streamlined regional structures or, to the contrary, for a streamlined health ministry and more elaborate regional structures. Québec does both.

The second example chosen by the committee concerns the **allocation of budgets in the network**.

— Budgets are allocated according to a so-called historical method, which neither encourages institutions to more extensively care for patients nor to enhance the efficacy and quality of care.

— Progress could be achieved by putting into general use activity-based funding, which is already the case in several developed nations. This funding method takes into account activities actually carried out and encourages efficiency.

Numerous solutions are thus available to us to better manage the healthcare system. We can do so by streamlining our administrative structures and by modernizing budget allocation methods through incentives that bolster productivity.

### ■ The education sector

The committee has noted that, in several respects, ways of spending public funds in the education sector are headed in the right direction. They are more likely to reduce costs and enhance performance than is the case in the healthcare sector.

— Resources are allocated according to activities and funding follows the client (in this instance, elementary and secondary school students and their parents, or post-secondary students).

— Competition with an extensive private sector also stimulates innovation and performance.

— Several evaluations of the results obtained are encouraging, although dropping out and the graduation rates are worrisome.

On the other hand, from the standpoint of structures, a cumbersome central and regional system manages the education sector. The same problem prevails here as in the healthcare sector.

### ■ Commercial government corporations

To illustrate what it is possible to do, the committee wished to analyse the performance and results obtained by three big Québec government corporations, i.e. the Société des alcools du Québec, Loto-Québec and Hydro-Québec. The only fairly detailed information concerning performance and benchmarking pertain to Hydro-Québec.

The committee deems the benchmarking of commercial government corporations to be essential: it allows for a credible evaluation of the corporations' results in terms of the quality of their management.

The implications for the way of spending public funds are direct and concrete: in the case of Hydro-Québec, we observe that better results would increase the revenues collected by the state shareholder or reduce financing needs, which lead to higher rates for consumers.

The results of the benchmarking of Hydro-Québec already obtained, which are often disappointing, should have been reflected in the demands submitted to the government corporation concerning its management. This does not appear to have been the case.

Moreover, it is to be hoped that analogous evaluation methods will one day be available in respect of the Société des alcools du Québec and Loto-Québec, with the same implications.

### ■ Comprehensive budgetary rules

In all developed nations, comprehensive rules applicable to the entire government budget frame ways of spending. These rules are necessary to structure the government's budget management.

The Act respecting the elimination of the deficit and a balanced budget, adopted in Québec in 1996, which subsequently became the Balanced Budget Act, is an example of such a rule, which targets balance between revenues and expenditures.

The comprehensive rules adopted in Québec could be more imaginative and define multi-year or sectoral requirements, following the example of the new rules applied in the Netherlands, which the OECD has suggested.

## ❑ Two principles

Based on its observations regarding expenditures, the committee is proposing two rules that the government should enact in the form of principles in order to better spend public funds.

### ■ First principle: generalize and depoliticize program performance assessment

The first principle that the committee is proposing with regard to government spending means that a more credible, more objective process must be implemented to review the efficacy of programs in order to depoliticize the process of assessing program performance. This review process must have a genuine impact on the way public funds are spent.

The committee suggests imitating the US Program Assessment Rating Tool (PART).

Furthermore, the committee wishes to emphasize that, in terms of the assessment of performance in the healthcare sector, the government could soon have at its disposal a very valuable tool with the establishment of the Institut national d'excellence en santé et en services sociaux (INESSS). Whether or not the draft legislation now before the National Assembly actually allows the new institute to assume such a role is another matter.

- **Second principle: encourage sound management, sanction poor management, and allow competition**

The second principle formulated by the committee reflects a well-known reality: emulation is the key to success, and this reality applies directly to the proper use of public funds.

There are several ways to encourage sound management and reward performance in the delivery of public services. Emulation can result from financial incentives geared to managers or organizations. It can also stem from competition.

The reform of the healthcare system that the Netherlands initiated in 2006 provides an example of what can be achieved by relying on competition.

Sound management can also be rewarded (and bad management sanctioned) during the budget-making process: the allocation of resources takes into account the results obtained and favours good managers. In the case of Québec, the committee cites the example of the Act to Provide for balanced budgets in the public health and social services network, non-compliance with which is not subject to any penalty, even though the Act explicitly stipulates that institutions must achieve such balance.

The committee examines the experience of government agencies, such as the Régie des rentes du Québec (not to be confused with regional bodies in the healthcare sector or school boards in the education sector). The creation of agencies is a step in the right direction since it is thus possible to introduce broader autonomy and stimulate performance while remaining in the public sphere. The concept of organizations affords another advantage: it produces observable results and, consequently, a credible assessment of performance.

## Can we better fund our public services?

The second part of this document examines the revenues that the state collects to fund public services.

### ❑ A strategic question given the amount of tax we pay

We are compelled to levy heavier taxes than elsewhere to fund our public services. We must, therefore, be especially effective in the definition of our taxation.

### ❑ More effective taxation

We can better fund our public services by defining effective taxation that does not jeopardize our economic development.

#### ■ The impact of fiscal levies on economic growth

The analyses conducted by the ministère des Finances confirm, in the case of Québec, a well-known phenomenon: user fees and consumption taxes have less negative impact on wealth creation than other forms of levies. These analyses corroborate studies conducted on the same topic by the OECD.

#### ■ The distribution of Québec's taxation is not efficient

The analysis of the distribution of taxes in Québec reveals that the distribution could be more efficient from the standpoint of economic growth: the weight of different taxes is not geared to maximize growth.

There exists a structural problem in the manner in which we distribute taxes. Despite the efforts made in recent years, our tax system is still overly concentrated on direct taxes, especially personal income tax, while the weight of our levies is similar to that in Europe. We can thus speak of a "Québec paradox."

In the context in which we live, this means that we must not, above all, raise income taxes:

— the impact on wealth creation would be extremely detrimental, particularly against a backdrop of demographic changes and their impact on the labour market;

— we must mobilize all of the means available to foster such wealth creation.

It is essential, at the same time, to ensure that recourse to the consumption tax does not widen inequalities in society.

Examples from Sweden, in particular, show that we can achieve this end, through spending programs and transfers to low-income earners. In this way, we can rely more extensively on consumption taxes without creating greater income inequality, relying on our redistribution programs.

### ❑ Rely more extensively on user fees

There is a second way to better fund our public services, through greater reliance on user fees.

#### ■ The advantages of user fees

User fees are a levy that is less detrimental to economic activity. Moreover, such fees foster sound behaviour by the users of services and the governments that offer them. There is a direct link between a user fee and efficiency. It should be noted that user fees compel us to ask ourselves about the relevance of the public service.

#### ■ We rely less extensively on user fees than neighbouring jurisdictions

The scope of our public services should normally lead us to rely more extensively on user fees than is the case elsewhere. In Québec, numerous private services are funded collectively. However, we have noted another characteristic of Québec: we barely rely on user fees, bearing in mind the extent of the private services that we fund publicly.

The data clearly reveal that we rely much less extensively on user fees than Ontario and the rest of Canada do, despite the scope of our public services.

### ❑ Two more principles

We can, in fact, better fund our public services by applying two principles.

— We must distribute fiscal levies by emphasizing the taxes that are least detrimental to economic growth, in particular consumption taxes.

— We must rely more extensively on user fees to fund our public services.

In the case of user fees and taxes, we must accompany recourse to this type of funding with measures that protect the poorest individuals.

## Conclusion

At the conclusion of the second phase of its approach, the committee has reached a major conclusion: given the extent of our expenditures and taxes, we must give priority to spending more effectively and better funding our public services.

— We can spend more effectively, i.e. better use the funds earmarked for funding public services.

— We can also better fund our public services.

### ❑ A source of hope

This offers us a source of hope. It means that by drawing lessons from what is done elsewhere, in some instances over a long period of time, it is possible to reduce the cost of the services now offered or provide more extensive services at the same cost.

In the healthcare sector, there are very specific examples of procedures that cost money and reduce what we obtain in relation to what we pay. This is also true in the education sector and in big commercial corporations such as Hydro-Québec.

At the same time, we can better fund our public services by defining effective taxation that does not jeopardize our economic development and by relying more extensively on user fees to fund public services, as is true in countries that offer extensive publicly funded services.

### ❑ Simple principles

We can achieve this end by applying several simple principles.

— We must put into general use and depoliticize the evaluation of program performance.

— We must encourage sound management, penalize bad management, and promote competition.

— We must define effective taxation and thus reduce the negative impact of any tax on economic development.

— We must rely more extensively on user fees.

### ❑ Concrete initiatives

These principles can rapidly lead to concrete initiatives, of which the committee has counted 10 or so.

The committee is confident that we can meet the challenges that we are facing from the standpoint of the economy and public finances. Much can be done without calling into question the basket of public services that the Québec government offers Quebecers.

We can spend more effectively and better fund our public services, although this implies that we make choices and act.

## The committee's impending deliberations

In keeping with the plan adopted at the outset of its deliberations, the Advisory Committee on the Economy and Public Finances will conclude its reflections by submitting to the government, in a third document, the options that it has found concerning revenues, expenditures and the debt, against a backdrop of wealth creation.

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# INTRODUCTION

The Minister of Finance established the Advisory Committee on the Economy and Public Finances in conjunction with the 2010-2011 prebudgetary consultation, which focuses on two key problems:

— the resumption of growth and major medium- and long-term economic policies in order to create the wealth needed to fund public services;

— the means to be implemented to achieve a balanced budget in 2013-2014 and to control the debt by the year 2025.

In keeping with the approach that it has adopted, the committee has initially sought to define the question by reviewing with concrete examples the current state of Québec's public finances.

## ❑ A statistical snapshot

The advisory committee's observations presented in the first document were summarized in a statistical snapshot.[6]

Québec funds more public services than Ontario does.

— Québec funds 26% more public service than Ontario does.

— If Québec offered Quebecers the basket of services that Ontario publicly funds, it would reduce its spending by $17.5 billion annually.[7]

Québec creates less wealth than Ontario does.

— Québec's GDP per capita is 14% lower than Ontario's per capita GDP.

— This means that Québec's potential tax base (adjusted according to its population) is $50 billion lower than Ontario's potential tax base.

To fund public services, we have opted for levying higher taxes and going deeper into debt than is the case elsewhere.

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6 *Ibid.*, page 49.

7 If Québec funded public services in the same way that the Ontario government does, its spending in 2008-2009 would have stood at $68.6 billion instead of $86.1 billion (data from the Statistics Canada financial management system adjusted by the ministère des Finances du Québec, *ibid.*, page 12).

We have got into debt mainly to fund current expenditures, which are commonly called "the groceries."

— Québec's gross debt, on which the interest payable is calculated, now stands at $150 billion.[8]

— Two-thirds of this amount comprises "bad debts," i.e. the accumulated deficits.

Our high level of indebtedness reduces our budget flexibility.

— Nearly 60% of the QST collected is allocated to debt service.

— We are increasingly vulnerable to interest rate fluctuations.

— We are more exposed than ever to fluctuations in federal transfers.

Despite this high level of indebtedness, we have not invested sufficiently in infrastructure, which is forcing us to catch up quickly.

Over time, our leeway has dwindled even as new challenges are looming on the horizon:

— higher healthcare costs;

— the impact of demographic changes on wealth creation;

— upgrading infrastructure.

## ❑ Make choices and act

In the first document, the committee pinpointed the consequences of these observations: Québec has now reached a limit. Our financial position is worrisome. The challenges that Québec will have to face are genuine, immediate and significant. It is thus necessary to make choices and act.

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8 See *ibid.*, page 29, concerning the concept of the Québec government's debt.

The choices to which the committee is referring should target:

— a level of public spending that is commensurate with our ability to pay;

— efficient taxation that does not jeopardize our economic development;

— debt that is under control and whose scope does not mortgage our children's choices.

These choices should enable Québec to benefit from balanced public finances in the long term and respect the ability of future generations to make their own choices, which is the very definition of sustainable development.

## ❑ Two possible solutions

In the second phase of its approach, the Advisory Committee on the Economy and Public Finances decided to focus its reflection on two possible solutions concerning expenditures and the funding of public services.

This document examines these two solutions.

### ■ Can we spend more effectively?

The first possible solution concerns expenditures. It has been broached in the form of a question: Can we spend more effectively?

In other words, can we ensure that the same quantity and quality of services cost us less?

Can we achieve this end by:

— better allocating the resources earmarked for our public services?

— adopting instruments and mechanisms that enhance the efficiency of the public sector?

The first part of this document attempts to answer these questions.

## ■ Can we better fund our public services?

The second possible solution pertains to revenues. The committee has also broached it in the form of a question: Can we better fund our public services?

This question leads to the choices that we must make to better fund the public services that we value.

— Among the different sources of funding to which we have access, which ones are the least detrimental to economic development? If we must increase taxation, which taxes is it preferable to increase?

— To fund services, should we not rely more extensively on user fees? Are we relying sufficiently on potential funding stemming from such fees?

The second part of this document is thus devoted to the questions raised about the manner in which we fund our public services.

# PART I

## Can we spend more effectively?

The first part of this document is devoted to expenditures. It comprises two sections:

— The Advisory Committee on the Economy and Public Finances first questioned **the manner in which we spend in Québec**, based on several concrete examples.

— The committee's observations led it to formulate **two principles**, which should dictate the requisite effort to better spend the money earmarked for public services.

The committee wanted to first explain in a brief introduction the meaning of the question that it is asking.

## THE QUESTION IS ALL THE MORE CRUCIAL AS WE ARE SPENDING HEAVILY

Our level of spending is high and the basket of services that we offer is extensive. It is, therefore, crucial to ask ourselves if we can spend more effectively.

Elsewhere in the world, innovative, effective methods have gradually been contemplated and implemented to better spend public funds. The methods have ensured, ultimately, that taxpayers obtain value for the money in relation to the taxes or fees that they pay.

It is thus essential that Québec in turn undertake a sweeping change in its way of spending.

### ❑ The committee is not calling into question the basket of public services

We must be clear. By asking whether we can spend more effectively, the committee has decided not to call into question at this juncture in its approach the basket of public services that the government offers.

Until now, questioning about the basket of public services has produced little in the way of results in Québec. Over the past quarter century, several reports have been submitted to the government, in which their authors recommended cutting or reducing certain services. Each time, suggested reductions or the calling into question of the basket of public services encountered stiff opposition from the clienteles directly concerned and led to their rejection.

The problem arises because the controversy surrounding a possible calling into question of the basket of public services overshadows other recommendations concerning reforms that we must apply to our ways of spending.

The committee has, therefore, decided to focus its reflection on the ways of spending and has carefully isolated this question from any reference to a possible redefinition of public services.

### ❑ Québec lags considerably behind

The committee is, in fact, convinced that Québec lags considerably behind from the standpoint of what is being done elsewhere in the world in terms of ways of spending public funds.

The allocation of budgets and the management of expenditures have changed little since public services were introduced in the 1960s and 1970s.

The committee is convinced that it is possible to provide more extensive services at the same cost or reduce the cost of the services now offered, provided that we adopt new approaches that have been proven elsewhere.

It thus hopes to heighten awareness among Quebecers of possible solutions that are within our reach if we are willing to modernize the way we use public funds.

**Calling into question the basket of public services is a difficult exercise that produces limited results**

The Québec government has, at regular intervals, sought to call into question the basket of public services that it offers. With very rare exceptions, these initiatives have never produced concrete results because of the opposition that they have engendered. Quebecers have thus not profited from the attendant benefits.

**Emphasis on the examination of structures**

In several instances, committees specifically analysed existing structures in the public sector, without much success.

- In 1986, the Groupe de travail sur la révision des fonctions et des organisations gouvernementales (Gobeil task force) formulated numerous recommendations aimed at streamlining government programs and bodies.
- In 1991, the Comité de travail sur la rationalisation des dépenses publiques (Poulin task force) took stock of concrete situations that seemed to exemplify the poor use of public funds and suggested measures to remedy these situations.
- In 1997, the Groupe de travail sur l'examen des organismes gouvernementaux (Facal task force) took stock of bodies in light of the corresponding government missions and issued recommendations concerning the maintenance, the abolition and the integration of the bodies, and the revision of criteria governing their establishment and management methods.

While certain recommendations formulated by these committees were implemented, the genuine impact of these deliberations on government structures has ultimately been marginal and the savings achieved have proven to be insignificant.

**The 2004-2007 modernization plan**

In 2004, the then President of the Conseil du trésor, Monique Jérôme-Forget, made public the 2004-2007 modernization plan (*Moderniser l'État*), which included, in particular, a process for systematically re-evaluating government bodies. The rule respecting the replacement of one civil servant out of two at the time of retirement stems directly from this plan.

## ❑ Sectors examined

In its examination of how we spend in the Québec public sector, the committee has intentionally confined itself to several sectors.

— The committee has first focused on **healthcare**, given the extent of spending devoted to it.

— It has also targeted the **education** sector and **big commercial government corporations**, mainly **Hydro-Québec**.

An analogous examination could have focused on other areas of government intervention, such as construction, where questions arose last fall concerning the management of expenditures.

— The committee rounded out this analysis of ways of spending by examining the **overall rules** applicable to expenditures to ensure fiscal discipline.

## ❑ Two principles

Despite its limitations, this examination has led to a number of observations, in light of which the committee has formulated the two principles that should dictate the efforts to be made to better spend funds earmarked for public services.

The committee is of the opinion that we must simultaneously:

— **better evaluate our performance**;

— **more broadly encourage managers to perform efficiently**.

The committee is convinced that it will thus be possible to reduce spending while maintaining services, or respond to growing needs by controlling costs.

## 1.1 SPENDING IN QUÉBEC

It its examination of how we spend in Québec, it was normal for the committee to first focus on health. The extent of healthcare expenditures and growth in such spending are a key problem in public finances.

We must remember that 30 years ago education, not health, was the Québec government's largest budgetary item. At that time, it accounted for over one-third of total program spending.

Health overtook education as the largest budgetary item in 1983-1984. In 2009-2010, healthcare accounted for 45% of Québec government program spending[9] and this proportion could exceed 50% in less than 10 years.

### 1.1.1 The healthcare sector

Numerous analyses and reports have focused on the healthcare sector. The Task Force on the Funding of the Health System, chaired by Claude Castonguay, conducted the most recent analysis of ways of spending in the healthcare sector.[10]

The fate of the report stemming from the deliberations of this task force illustrates the phenomenon emphasized earlier. The report proposed numerous examples and suggestions concerning the best ways to spend by comparing current practices in Québec with initiatives undertaken in a number of developed nations.

These suggestions were not examined seriously: the rejection of the report's recommendations concerning the role of the private sector and funding costs (an increase in the QST and the allocation of proceeds from this increase to healthcare) precluded the examination of the recommendations aimed at ways of spending.

The committee wishes to return to the report: the task force's analyses of the way of spending have never been more relevant and are based on foreign experience that has borne fruit.

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9 See *ibid.*, page 41.

10 *Getting Our Money's Worth*, report of the Task Force on the Funding of the Health System, Québec, February 2008.

## Repeated attempts to enhance the functioning and funding of the healthcare system

Over the years, a number of committees and task forces have studied the enhancement and funding of the healthcare system and have made recommendations, many of which were not implemented.

**In Québec**

**1988** – The Commission d'enquête sur les services de santé et les services sociaux (Rochon commission) tabled its report, in which it severely criticized the management of the system and made recommendations to enhance the system's operation.

**1991** – Former Minister of Health and Social Services Marc-Yvan Côté unveiled *Un financement équitable à la mesure de nos moyens*. In his report, he advocated that Quebecers assume greater responsibility in their consumption of healthcare services in order to reduce pressure on public finances.

**1998** – The Arpin committee had a mandate to take stock of the complementarity of the private sector in the pursuit of basic objectives in the public healthcare system. The task force recommended maintaining the existing mechanisms under which physicians were unable to offer on the market medical services already insured by the public healthcare system without completely withdrawing from the public health insurance scheme. However, the task force proposed that a partnership be developed between the public and private sectors.

**2000** – The Comité pour la révision du Cadre de référence sur les services à domicile submitted to the government its report entitled *Politique de soutien à domicile des personnes ayant des incapacités et de soutien aux proches*, known as the Anctil report. It recommended increasing home support spending by 20% a year over the subsequent three years and avoiding subjecting home support services to a closed budget allowance.

**2001** – The Commission d'étude sur la santé et les services sociaux, chaired by Michel Clair, made public its report entitled *Les solutions émergentes*, which recommended, in particular, the reorganization of front-line service delivery through the establishment of family medicine groups comprising six to 10 physicians accessible to patients 24 hours a day, seven days a week, the creation of an insurance fund covering the "loss of autonomy," funded by taxpayers, and the implementation of an integrated service network for seniors experiencing a loss of autonomy.

**2002** – The Comité sur la réévaluation du mode de budgétisation des centres hospitaliers de soins généraux et spécialisés (CHSGS) submitted its report. It proposed a new budget-making process for hospitals to better reflect changes in the volume of patients and the complexity of their problems and foster the relative performance of the institutions, while maintaining adequate control over the budgets allocated.

**2004** – The Groupe de travail ministériel sur le cancer submitted its report (the Deschênes report) and recommended the adoption of integrated services, the optimization of clinical practices, continuous improvement of the quality of healthcare delivery, and the introduction of centralized governance to combat cancer.

**2005** – The Comité de travail sur la pérennité du système de santé et de services sociaux du Québec, chaired by Jacques Ménard, made public its report entitled *Pour sortir de l'impasse, la solidarité entre nos générations*. The committee proposed solutions to fund the Québec healthcare system, in particular by according a bigger role to the private sector while maintaining strictly public funding, by creating an old age insurance scheme to cover the loss of autonomy, by increasing electricity rates to repay the debt, and by increasing the QST to cover the short-term shortfall.

**2008** – The Task Force on the Funding of the Health System, chaired by Claude Castonguay, submitted its report, *Getting Our Money's Worth*, which is an evocative title. The task force emphasized that "Québec must secure the long-term viability of the public health care system by increasing its productivity and adjusting the growth in public health spending to the growth rate of Québec's economy, while improving access to care and quality of services."

**In Canada**

**1984** – The Canada Health Act was adopted. Through the Act, and by making conditional its financial contribution to the provincial healthcare systems, the federal government imposed on the provinces and territories compliance with certain requirements such as universal, free access to insured healthcare services covered by the public scheme.

**2002** – The Commission on the Future of Health Care in Canada, chaired by Roy Romanow, submitted its final report, entitled *Building on Values: The Future of Health Care in Canada*. The report recommended giving greater weight to the Canada Health Act, investing an additional $8.5 billion before 2004 in the healthcare system and increasing by 25% federal healthcare funding before 2005-2006. Moreover, the commission advocated the establishment of a Canada Health Council and suggested the introduction of a national electronic health record system.

**2002** – The Standing Senate Committee on Social Affairs, Science and Technology, chaired by Michael J.L. Kirby, submitted six reports. The committee recommended to the federal government the investment of an additional $5 billion a year in healthcare to ensure the system's financial viability, to be funded by a national health insurance premium that would vary according to personal income.

Two examples drawn from the report seem particularly illustrative in this regard:

— The first example concerns the management structures of our healthcare system.

— The second example pertains to the manner in which budgets are allocated in the network.

## ❑ The management structures in our healthcare system

The management structures in our healthcare system are first distinguished by the very highly centralized decision-making process.

— The ministère de la Santé et des Services sociaux (MSSS) is actively involved in the micromanagement of the system. For example, the Minister's approval is required to open a family medicine group or a specialized medical centre.

— Québec legislation and regulations impose on managers at all levels a rigid, detailed framework. All processes are imbued with a top-down culture.

Another problem arises because the Québec healthcare system juxtaposes an extensive central structure and a highly developed regional structure.

— The central structure comprises roughly 900 civil servants divided into seven branches and nearly 20 administrative units covering all facets of health and social services.

— The structure in the region encompasses 15 health and social services agencies and three other regional organizations. Regional responsibilities are also attributed to 95 health and social services centres (CSSS).

This dual structure has a significant direct cost, estimated in 2009 at nearly $600 million a year. Above all, it affects the system's operation, which it encumbers considerably: roles are not clearly apportioned and overlapping occurs between the central administration and the regional agencies.

As the report of the Groupe de travail sur le financement du système de santé emphasized, the OECD countries have, generally speaking, opted for a strong health ministry and streamlined regional structures or, to the contrary, for a streamlined health ministry and a more elaborate regional structure.[11] Québec does both.

11 *Ibid.*, page 165.

## ❑ The allocation of budgets in the network

The second example chosen by the committee concerns the allocation of budgets in the network.

### ■ A historical method that takes into account the characteristics of the population

The MSSS allocates budgets to the regional agencies by means of a so-called historical method, which is shifting toward an approach that takes into account the characteristics of the population.

Analogous rules apply to the budgets that the regional agencies allocate to the institutions, i.e. hospitals and the CSSSs. Essentially, the regional agencies also earmark their resources for the institutions according to a historical method. New approaches are starting to emerge, based on the characteristics of the population.

The historical method has several advantages:

— It is simple to administer.

— It affords the institutions stable, predictable funding.

However, this method has two pernicious effects:

— The budgeting method based on a historical approach does not encourage the hospitals and CSSSs to care for more patients.

— The historical method does not take into consideration the institutions' performance. It does not encourage them to enhance the efficacy and quality of care.

The introduction of approaches that take into account the characteristics of the population reduce iniquities between institutions and regions. However, with a few rare exceptions, these approaches offer no incentive to bolster the institutions' performance.[12]

12 For several years, the budgets that the MSSS has allocated to the regional agencies take into account certain facets of performance. In practice, however, this approach is very limited. Furthermore, the MSSS has no guarantee that the regional agencies transmit this consideration of performance to the institutions.

## ■ We must strive to achieve activity-based funding

We could make considerable progress in the manner in which budgets are allocated if we adopted as a rule a method of budget allocation that takes into account activities actually carried out, thus encouraging efficiency, as is the case elsewhere.

The government does not, *a priori*, establish the institutions' resources under activity-based funding. The resources are determined by the medical activities actually carried out.

— This is public funding centred on the patients, who are considered to be a source of revenue rather than a cause of expenditure.

— This method of funding also empowers the patients to orient change in the desired direction through the choice they make in visiting one institution instead of another one.

Several developed nations, including France, Germany, the United Kingdom and the Netherlands have already adopted activity-based funding. However, the adoption of this funding method demands a radical change of culture: "the logic of the request for funds under supervision is abandoned in favour of a results-based logic, for which the institution is responsible."[13]

**The French healthcare system relies on accountability and competition**

The World Health Organization ranks the French healthcare system as the most efficient from the standpoint of the delivery and organization of healthcare.

Waiting lists and shortages of physicians and nurses are virtually unknown. The French healthcare system is highly controlled and relies extensively on the financial responsibility of insured parties, on the private sector for healthcare delivery, on competition, and on the efficiency of management.

For example, France has introduced activity-based funding as the principal funding method in public and private hospitals.

- Activity-based funding is intended to base the allocation of resources to public and private healthcare institutions on the nature and volume of activities carried out.
- This funding method, adopted in 20 or so countries, seeks to enhance efficiency in the delivery of healthcare and transparency in the use of resources.
- Compared with the comprehensive allocation system (historic or population-based), activity-based funding gives the institutions greater freedom and responsibility by streamlining constraints and procedures and encouraging them to optimize the use of their resources.

13 *Mission d'évaluation et de contrôle de la sécurité sociale de la commission des Affaires sociales sur la gestion de l'hôpital*, Rapport d'information n° 403 (2007-2008), Sénat français, June 2008.

## ■ The fee-for-service payment is a form of activity-based funding

It should be noted that the Québec healthcare sector already relies on a funding method that takes into account activities, the fee-for-service payment that remunerates physicians.

From the standpoint of management, the fee-for-service payment is the key tool available to the government to effectively spend the funds allocated to paying physicians. Like all individuals, physicians react quickly and directly to the remuneration that they receive and the incentives that it implies.

The difficulty here arises because, since its inception in the early 1960s, the system has not really changed. However, the relative value of the services and the system itself should take into account technological advances and changes in needs and the pathological profile of patients stemming from the ageing of the population.

### The computerization of physicians' offices: another illustration of how Québec lags in its way of spending

The degree of computerization of physicians' offices provides another example of how Québec lags in its way of spending in the healthcare sector.

**Computerized medical records**

In Canada, only 23% of physicians' offices are equipped with electronic medical records, compared with 89% in the United Kingdom and 98% in the Netherlands.[1]

In Québec, 81% of family physicians still rely solely on printed medical records. Fewer than 2% of family physicians maintain completely computerized patient files, which puts Québec far behind provinces such as British Columbia or Ontario, where roughly 13% of family physicians work solely with computerized files. This proportion stands at 33% in Alberta.[2]

**Experience in Denmark**

In Denmark, 97% of physicians issue electronic prescriptions, compared with 71% in the Netherlands and 81% in Sweden.[3]

Denmark's reliance on the potential of computerization has been highly profitable. According to a study conducted in 2006,[4] this initiative saves €872 million a year.

1 Karen Davis *et al.*, "Health Information Technology and Physician Perceptions of Quality of Care and Satisfaction," *Health Policy*, No. 90, 2008.

2 National physician survey, 2007: http://www.nationalphysiciansurvey.ca/nps/2007_Survey/2007nps-f.asp., page viewed in January 2010.

3 Dobrev A. *et al.*, *Benchmarking ICT Use among General Practitioners in Europe: Final Report*, European Commission, Information Society and Media Directorate-General, April 2008.

4 Jonathan Edwards, *Case Study: Denmark's Achievements with Healthcare Information Exchange*, Gartner Inc., 2006.

### ❑ The Québec healthcare system does not encourage performance

The two examples that the committee has presented illustrate a fundamental point: there are few incentives in the Québec healthcare system to enhance its performance. The patient is regarded as an expense and not as a source of revenue.

This explains the persistent difficulties in the system, despite the considerable sums that are invested year after year in it. Budgets are rising steadily while access to care continues to be problematical and waiting times lengthy.

### ❑ It is possible to better manage the healthcare system

As we have noted, numerous avenues are open to us to better manage the healthcare system:

— We can do so by streamlining our administrative structures.

— It is also possible to improve the management of the Québec healthcare system by modernizing our budget allocation methods and relying on incentives that bolster productivity.

This means that we can thus control at least part of the increase in costs, without calling into question public funding or the basket of services offered to Quebecers.

### 1.1.2 The education sector

The education sector ranks second after healthcare in importance among the public services that the Québec government offers.

We have noted that, from the standpoint of the management of public funds, fewer reports have dwelt on the education sector than on the healthcare sector[14] and, above all, most of the reports have not examined the system's performance.[15]

#### ❑ Observations

However, the limited number of analyses available allows us to make certain observations.

##### ■ The juxtaposition of central and regional structures

As is true in the healthcare sector, the education system has adopted an imposing central structure and a highly developed regional structure.

— At the elementary and secondary level, the school boards play a role that is analogous to the role that healthcare agencies play.

— In the same way as in the healthcare sector, the coexistence of two big administrative structures represents a high direct cost and significantly encumbers the system's operation.

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14 Over the past 15 years, four reports have shaped reflection on the Québec education system, i.e. the final report of the Commission des États généraux sur l'éducation 1995-1996, *Rénover notre système d'éducation : dix chantiers prioritaires* (October 1996), the final report of the Commission de l'éducation in the wake of the Consultation générale sur les enjeux entourant l'accessibilité et le financement des universités au Québec (June 2004), *L'éducation : l'avenir du Québec. Rapport sur l'accès à l'éducation* (October 2005), and *Les modes de financement de l'éducation : rapport intégrateur faisant suite aux travaux d'experts chercheurs* (June 2007). These reports examined broader access to education and funding for the Québec education system, especially university education.

15 Two other reports focused more specifically on the performance of the education system, i.e. *Les études secondaires et postsecondaires : propositions de réorganisation pour améliore la performance du système d'éducation au Québec* (September 2003), prepared by Denis Bédard at the request of the Fédération des commissions scolaires du Québec, and the report of the Groupe d'action sur la persévérance et la réussite scolaires au Québec, *Savoir pour pouvoir* (March 2009), elaborated under the direction of Jacques Ménard.

### ■ Activity-based funding is a positive point

On the other hand, budgets are allocated according to activity, unlike the healthcare system. In the education sector, public funding follows the students, who are deemed to be a source of revenue rather than a cause for expenditure.

We noted earlier the advantages of activity-based funding: this funding method affords elementary and secondary school students and their parents and post-secondary students an opportunity to influence management. There is thus an incentive to encourage managers to enhance the quality of management. If students are dissatisfied with the instruction offered to them, they will attend a different institution, along with the public funding linked to their attendance.

This does not mean that the method of allocating public funds in the education sector is irreproachable. In the universities, for example, the formula used to define funding for different training programs stems, in practice, from strategic negotiations between the universities and the government, since it is applied in conjunction with a closed budget allowance. It is also fairly arbitrary. In the Cegeps as in the universities, efforts should be made to better gear education to the needs of the workplace.

However, overall, the education sector relies on funding methods that are moving in the right direction. These funding methods have all the more impact since competition exists in the elementary and secondary school sector and in the Cegeps and universities.

## ❑ Two examples

The committee focused on two examples that illustrate expenditure management in the Québec education system, with their positive points and areas for improvement, in relation to experience abroad.

These examples concern:

— the existence, above all at the secondary school level, of an extensive private sector;

— the evaluation of results.

- **The presence of the private sector in elementary and secondary school education is an advantage**

The presence of an extensive private education sector, above all at the secondary level, allows Québec to take advantage of emulation between the two systems.

— The coexistence of a public system and a private system engenders competition that benefits Quebecers.

— Private schools compel public schools to be inventive in order to preserve their clientele.

— The opposite is also true: public schools, through their initiatives, impose on private schools performance criteria that benefit the students.

The coexistence of the public sector and an extensive, dynamic private sector must also be regarded as an asset, even though the private sector is accused of creaming off the best students from the public sector.

- **The case of Sweden**

It should be noted that Sweden has gone much farther in this direction.

Sweden has systematized and put into general use the coexistence of private and public schools and totally funds private schools. In 1991-1992, when the reform was initiated, Sweden had 90 private schools for students between 6 and 19 years of age. In 2006-2007, the number of private schools had risen to 900, a tenfold increase in 15 years.

At the same time, Sweden succeeded in providing a convincing response to the problem of accommodating difficult students.

This system has completely transformed the Swedish education system. Today, citizens have access to a vast network of public and private institutions offering highly varied programs and teaching methods.

— By granting the schools considerable latitude in management and the definition of educational practice, the state has allowed them to develop innovative teaching programs.

— Moreover, free private schools have spurred the development of new, more dynamic schools in underprivileged neighbourhoods.

**The Swedish educational revolution:**
**free schooling, pedagogical freedom and competition between the public and private sectors**

Over the past 15 years or so, a veritable educational revolution has occurred in Sweden, not only from the standpoint of instructional methodology but also as regards the funding method.

As is true of public schools, accredited private schools are entirely free of charge. Furthermore, Sweden has adopted the "education cheque," through which the government undertakes to fund children's education whether it is provided by a public or a private institution. An individual amount is allocated to each child to fund his education from kindergarten up to and including secondary school. Once the national school education branch has accredited private schools, the latter are thus funded by the state and must, in return, avoid charging tuition fees. However, they are authorized to receive private donations.

The principle is simple: the choice of the school is up to the parents and they will choose the best school for their children. If the neighbourhood school does not meet the parents' expectations, they may opt for another school, whether public or private.

This system seeks to foster competition between schools and enhance the quality and diversity of instruction. Public institutions and private schools are encouraged to adapt to this competition, since those that attract the most students obtain the most funding.

## ■ The evaluation of results

The evaluation of the results that different clienteles in the education system achieve is crucial, if we wish to measure the efficacy of the instruction offered.

Several evaluations of the results achieved by the Québec education system, conducted at regular intervals, shed contrasting light on the matter.

### ▪ The ranking established by *L'actualité*

The annual ranking of schools that *L'actualité* magazine publishes illustrates the difficulty of conducting evaluations, even though there is a genuine demand from the public to do so.

The annual publication of this ranking is eagerly awaited but also controversial. The ranking is not produced by the government but it cannot be produced without its support. In 2009-2010, it was not published in the absence of essential data from the ministère de l'Éducation, du Loisir et du Sport.

*L'actualité*'s ranking has considerable repercussions since it covers the secondary level, in which there is an extensive private sector and thus stiff competition between educational institutions.

- **The PISA evaluation**

Another evaluation, the Programme for International Student Assessment (PISA), is much less contentious because of its more global nature and the results that Québec students obtain on it. The member countries of the OECD have applied it since 2000.

The results that Québec students regularly obtain on the evaluation confirm the qualities of the Québec education system.

TABLE 1

**Ranking of OECD countries[1] and Québec's ranking on the PISA tests[2] – 2006**

| | Mathematics | Reading | Science |
|---|---|---|---|
| 1 | Taiwan | South Korea | Finland |
| 2 | Finland | Finland | Hong Kong |
| 3 | Hong Kong | Hong Kong | Canada |
| 4 | South Korea | Canada | **Québec** |
| | **Québec** | **Québec** | Taiwan |
| 5 | Netherlands | New Zealand | Estonia |
| 6 | Switzerland | Ireland | Japan |
| 7 | Canada | Australia | New Zealand |
| 8 | Macao | Liechtenstein | Australia |
| 9 | Liechtenstein | Poland | Netherlands |
| 10 | Japan | Netherlands | South Korea |
| 11 | New Zealand | Sweden | Liechtenstein |
| 12 | Belgium | Belgium | Slovenia |
| 13 | Australia | Estonia | Germany |
| 14 | Estonia | Switzerland | United Kingdom |
| 15 | Denmark | Japan | Czech Republic |
| 16 | Czech Republic | Taiwan | Switzerland |
| 17 | Iceland | Germany | Austria |
| 18 | Austria | United Kingdom | Macao |
| 19 | Germany | Denmark | Belgium |
| 20 | Slovenia | Slovenia | Ireland |

1 Organisation for Economic Co-operation and Development.
2 Programme for International Student Assessment (PISA).
Sources: OECD, McKinsey & Company. Drawn from the report of the Groupe d'action sur la persévérance et la réussite scolaires au Québec, 2009.

## The PISA: a means of evaluating elementary and secondary school instruction

### The PISA

In 2000, the OECD member countries implemented the Programme for International Student Assessment (PISA) in order to provide international indicators on the knowledge and skills of 15-year-old students. The PISA measures the results obtained by young people in three subjects, i.e. mathematics, reading and science, by emphasizing what the students can accomplish using what they have learned in school, at home and in the community.

The 2006 PISA evaluated the performance of students from 57 countries, including the 30 member nations of the OECD. In Canada, roughly 22 000 15-year-old students from some 1 000 schools participated in the program. A vast sampling was selected to produce data both for Canada as a whole and for the provinces.

### Among the best in the world... and in Canada!

Canadian and Québec students rank among the best in the world, regardless of the subject evaluated by the PISA, i.e. mathematics, reading or science, ahead of countries such as France, Germany, Switzerland and the United Kingdom.

The 2006 PISA revealed that Canada ranked seventh in mathematics, fourth in reading, and third in science. Québec was surpassed only by Taiwan, Finland, Hong Kong and Korea in mathematics and Québec students ranked first among the Canadian provinces.

In reading, Québec's score was equivalent to the Canadian average, ranking just after South Korea, Finland and Hong Kong.

Québec's performance in science must also be underscored. In Canada, Québec students were surpassed only by Alberta and Ontario. Within the OECD, Québec headed the list, after Finland, Hong Kong and Canada.

### One means among others

While the PISA is limited in the evaluation of the knowledge and skills of 15-year-olds (science, reading or mathematics), it is nonetheless a credible, necessary means of assessing the efficacy of elementary and secondary school instruction in Québec, particularly in an era of globalized economic competition.

In the same way as an analysis of the causes of dropping out or the low graduation rate, the PISA must be part of any approach to ascertaining the means to adopt to enhance the efficacy of instruction in Québec.

- **The measurement of secondary school graduation rates**

The measurement of graduation rates also enables us to evaluate results in the education sector.

Our observations in this respect are much more favourable to the Québec education system.

— For the period 2005-2008, Québec ranked ninth in Canada with respect to graduation with a high school diploma within the period specified, although such a diploma requires one less year of study in Québec. Québec ranked 7th in 1997.

— Canada ranked 16th out of 30 in the OECD according to data for 2005-2006.

TABLE 2

**Ranking of the OECD countries and the Canadian provinces concerning graduation rates**
(as a percentage)

| | **Ranking of the OECD countries* % of the population that obtained the equivalent of an HSD or an SSVD** within the period specified 2005-2006** | **Ranking of the Canadian provinces*** Graduation rate, population between 20 and 34 years of age 2005-2006 to 2007-2008** |
|---|---|---|
| 1 | Germany | British Columbia |
| 2 | Greece | Ontario |
| 3 | Finland | New Brunswick |
| 4 | South Korea | Nova Scotia |
| 5 | Japan | Saskatchewan |
| 6 | Norway | Newfoundland and Labrador |
| 7 | Iceland | Prince Edward Island |
| 8 | Czech Republic | Alberta |
| 9 | Switzerland | **Québec** |
| 10 | United Kingdom | Manitoba |
| 16 | **Canada** | |
| 18 | United States | |
| 28 | France | |

* *OECD Education Outlook 2008*; data for the years 2005-2006.
** High school diploma or secondary school vocational diploma.
*** Statistics Canada, average for the school years 2005-2006 to 2007-2008.
Sources: OECD, Statistics Canada and McKinsey & Company. Drawn from the report of the Groupe d'action sur la persévérance et la réussite scolaires au Québec, 2009.

- **Dropping out**

The problem of dropping out also raises questions of assessment.

Dropping out is a genuine social problem that goes beyond questions of budgeting and the management of the education sector.

In March 2009, the Groupe d'action sur la persévérance et la réussite scolaires au Québec, chaired by Jacques Ménard, published a report that took stock of the question and the initiatives to be taken to resolve the current difficulties.[16]

This report emphasizes the importance of having available evaluations of the efficacy of existing programs. It notes that "the abundance of programs and initiatives [that directly or indirectly affect persistence in school] raise the question of their efficacy. Are we suffering from a lack of intensity in action? Are our practices the right ones? The widespread absence of the measurement of results in the realm of persistence in school in Québec does not allow us to answer these questions convincingly."[17]

## ❑ Ways of spending that are moving in the right direction

To conclude, the committee has noted that, in several respects, the ways of spending public funds in the education sector are moving in the right direction. They are more likely to reduce costs and enhance performance than in the healthcare sector.

— The sector relies on activity-based funding and funding follows the client, i.e. elementary or secondary school students and their parents, or post-secondary students.

— Competition with an extensive private sector also stimulates innovation and performance.

— Several evaluations of the results obtained are encouraging, even though dropping out and the graduation rate are worrisome.

On the other hand, from the standpoint of structures, the education system is managed by a cumbersome system at the central and regional levels. This problem has already been pinpointed in respect of the healthcare sector.

16 Groupe d'action sur la persévérance et la réussite scolaires au Québec, *op. cit.*

17 *Ibid.*, page 22.

### 1.1.3 Commercial government corporations

Commercial government corporations must be included in this review concerning the progress that needs to be made to improve how resources allocated to public services are spent.

To illustrate what is possible, the committee has studied the performance and results obtained by three of Québec's largest government corporations: the Société des alcools du Québec, Loto-Québec and Hydro-Québec.

— All three are commercial corporations and enjoy a total or partial monopoly in their activity sector.

— The Act respecting the Governance of state-owned enterprises, passed on December 14, 2006, to which the Société des alcools du Québec and Loto-Québec are subject, stipulates that, every three years, the Auditor General or, if he considers it appropriate, an independent firm must carry out an assessment of the efficiency and performance of these corporations, including benchmarking with similar enterprises. The Hydro-Québec Act has similar provisions.

— The committee notes that in the case of the Société des alcools du Québec and Loto-Québec, there is still no rigorous and comprehensive measurement of the organizations' efficiency, compared to public or private organizations carrying out similar activities in neighbouring jurisdictions.

#### ❑ Benchmarking of Hydro-Québec: disappointing results

In the case of Hydro-Québec, we have access to information that allows components of the government corporation's performance to be measured.

Concerning transmission and transmission lines, Hydro-Québec Trans-Énergie's performance is equal to or better than the average performance of benchmarking participants.

— Regarding distribution, Hydro-Québec Distribution's results are considerably poorer.

— Benchmarking is carried out using a set of indicators measuring costs and continuity of service. Overall, Hydro-Québec Distribution ranks 9th out of 14 in 2007 (date of the most recent assessment).

— Results have improved compared to prior years (Hydro-Québec Distribution ranked 16th out of 18 in 2006 and 17th out of 19 in 2005). However, the results are still disappointing since those for 2007 place Hydro-Québec in the third quartile, i.e. the third quarter of all the companies compared.

— Taking one of the activities included in the benchmarking, namely customer service, as an example, Hydro-Québec Distribution's performance is seen to be below average. In this case alone, Hydro-Québec Distribution would have achieved annual savings of $60 million had its costs per subscriber been comparable with those of more efficient enterprises.

### ❑ Gains for the consumer as well as the taxpayer

A number of comments can be made regarding the Hydro-Québec example.

— Benchmarking of commercial government corporations is fundamental: it provides a credible assessment of the results of these corporations regarding the quality of their management.

— The implications as to how public money is spent are direct and concrete: in the case of Hydro-Québec, we see that better results would increase the revenue of the government as shareholder, or reduce financial requirements reflected in higher rates for consumers.

— The results of Hydro-Québec's benchmarking obtained in the past should have been reflected in the requirements applied to the government corporation as to its management. That does not appear to have been the case.

— It is to be hoped, in passing, that similar assessment methods will be available at some point for the Société des alcools du Québec and Loto-Québec – with the same implications.

## External Benchmarking at Hydro-Québec

The Hydro-Québec Act (R.S.Q. H-5) stipulates that the Corporation must assess its efficiency and performance, including benchmarking with similar enterprises carried out by an independent firm every three years.

**Hydro-Québec Distribution**

Since at least 2003, Hydro-Québec Distribution and Hydro-Québec Trans Énergie have carried out benchmarking of their activities to identify gaps that exist between them and more efficient enterprises. In 2008, Hydro-Québec Distribution participated in two separate benchmarking programs conducted by First Quartile Consulting, the first one covering distribution activities (the Transmission & Distribution program) and the other customer service (the Customer Service program).

Benchmarking of the distribution system shows that in spite of an improvement in its overall rank in 2007 (9th out of 14) compared to 2006 (16th out of 18), Hydro-Québec Distribution still performs less well that most other comparable enterprises.

**Rank of Hydro-Québec Distribution from 2004 to 2007[1] – Transmission & Distribution**

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| | Rank out of 27 | Rank out of 19 | Rank out of 18 | Rank out of 14 |
| Overall ranking | 17 | 17 | 16 | 9 |
| Costs | 13-15 | 11-13 | 6-10 | 9 |
| Continuity | 13-14 | 12-14 | 12 | 9 |
| Security | 22-23 | 18 | 17 | n/a |

1 Benchmarking conducted by PA Consulting for 2004 to 2006 and by 1QC for 2007.
Source: HQD-7, document 2 filed by Hydro-Québec with the Régie de l'Énergie.

However, this ranking does not allow an assessment of the savings Hydro-Québec Distribution could realize for its distribution activities if its costs were comparable with those of enterprises that performed better. The benchmarking results for customer service indicate that if Hydro-Québec Distribution's costs per subscriber were comparable to enterprises that perform better, the company would have achieved savings estimated at roughly $60 million in 2005 and in 2007.

In addition, the other benchmarking components for customer service show that the performance of Hydro-Québec Distribution's telephone service deteriorated in 2007, thus contributing to its ranking among enterprises that performed less well.

### 1.1.4 Comprehensive budget rules

In all developed countries, how spending is carried out is framed by comprehensive rules applicable to the government's entire budget. These rules are necessary to frame the government's budgetary management.

However, they cannot replace new ways of doing things as far as spending is concerned: they apply at a different level and, rather, frame and reinforce the overall sound management of public finances.

#### ❑ The goal: compel compliance with predetermined budget targets

The comprehensive rules applicable to the government's entire budget generally consist of legislation. Their goal, and their result, is to constrain the government concerned, by forcing it to comply with predetermined budget targets.

The Act respecting the elimination of the deficit and a balanced budget, passed in Québec in 1996, which has since become the Balanced Budget Act, is an example of such a rule, taking as its target balanced revenue and spending.

#### ❑ Examples of rules

Other rules have been adopted in many European countries.

— In the United Kingdom, the rule is to keep the budget balanced over the length of a business cycle.

— In Sweden, the government adopted a rule designed to maintain an average budget surplus of 1% of GDP over the business cycle.

— In Switzerland, under the debt restraint rule, the Confederation's accounts must be kept in balance over a business cycle as a whole.

— In Germany, the rule is the same as in Québec: the budget must be balanced each year.

— Moreover, Germany and the United Kingdom authorize deficits only for capital investments.

Other comprehensive rules are applied in Québec, namely:

— only one out of every two retiring public servants is replaced,

— the rule concerning infrastructure maintenance (funds must be allocated to maintain assets and reduce the maintenance deficit).

These comprehensive rules have proven essential to compel spending control.

The Netherlands have added sector-based requirements to their comprehensive rules.

— The rule is to keep the budget balanced over the entire length of a government's mandate.

— The government must define a multi-year budget framework limiting the real spending of each major sector (central budget, health, social security).

— Spending must remain within the limits set for the length of the government's mandate.

— Each department knows its medium-term spending objectives. The responsible officials can focus on quality of spending rather than its amount.

Like the Netherlands, other governments in Canada such as Ontario, Alberta and British Columbia include spending forecasts by department over many years in their budget.

### ❑ Possible progress

The comprehensive rules used in Québec could be more imaginative and define multi-year or sector-based requirements, following the example of the new rules applied in the Netherlands.

Indeed, this suggestion has been made by the OECD.[18]

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18 OECD, Government at a Glance 2009, p. 91.

## Spending public money more effectively: it can be done

The examples given above show that it is quite possible to spend public money more effectively without calling public services into question.

Without going into exhaustive detail, the committee has provided examples of these possibilities by successively dealing with how services are delivered in the health sector and the education sector, as well as within a commercial government corporation, namely Hydro-Québec.

The observations that result concern structures first of all, and that is nothing new: most often, and especially in the health sector, structures are cumbersome and leave little room for management initiative.

The observations also apply to how things are done, which the committee wishes to stress:

— There are too few assessments. When they are carried out, there is no budgetary application.

— There is no real performance encouragement, even though that is essential where managers are placed in a situation in which real competition is nonexistent.

On the basis of these two observations, the committee is proposing two rules that the government should enact as principles in order to spend public money more effectively.

These principles concern:

— program assessment;

— encouraging good management.

## 1.2 TWO PRINCIPLES

The committee is convinced that we can improve how we do things, as far as public spending is concerned, by applying two principles that enable better assessment of our performance and further encouragement for our managers to perform better – without calling the basket of services into question.

These principles could be stated as follows:

— Program performance assessment must be generalized and depoliticized.

— In addition, good management must be encouraged, poor management sanctioned and competition must be allowed.

### 1.2.1 First principle: generalize and depoliticize program performance assessment

The first principle the committee is proposing regarding public spending means that a more credible and more objective program efficiency review process must be implemented, in order to depoliticize the program performance assessment process. This review process must have a real impact on how public money is spent.

In the Inaugural Address marking the beginning of his mandate, January 20, 2009, President Obama summed up the challenge well:

> "The question we ask today is not whether our government is too big or too small, but whether it works [...] those of us who manage the public's dollars will be held to account, to spend wisely, reform bad habits, and do our business in the light of day.Only then can we restore the vital trust between a people and their government."[19]

#### ❑ Independent assessment

Program performance assessment must be independent. The independence of the assessment will protect politicians from pressure brought to bear by service providers who reject such assessment.

The assessment must be credible. That means it must be carried out by an authority or organization with the required know-how, and it must be possible to compare the results obtained with those of programs used as references.

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19 President Barack Obama's Inaugural Address calling for a "new era of responsibility", Washington White House, 20 January 2009.

## ❑ Assessment with consequences

The assessment must have an impact on how money is spent and on budget-making. There is no use carrying out an assessment if the results have no effect on the allocation of budgets or on how public funds are used.

In Québec, it appears that performance assessment, when carried out, has no real consequences on the allocation of budget resources. An expert on the matter came to this conclusion in 2009, in a book focusing on budgetary management and public spending in Québec.[20]

It states:

> "Performance-based budgeting establishes [...] an explicit link between information on results and decision-making and in theory seeks to reward those with the best performance and sanction those with poor performance. However, reality is not so simple [...]. So far, the end result appears to focus more on informing decision-making than on allocating resources consistent with performance."[21]

## ❑ An example to follow: the American PART

Many OECD countries adopted results assessment in the mid-1980s. The most convincing experience is the Program Assessment Rating Tool (PART) set up by the U.S. federal government (Office of Management and Budget).

Since 2002, this initiative has been used to systematically assess and rank 1 000 programs. The results are used by the President's office to reallocate resources and gain room to manoeuvre.

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20 Pierre Cliche, *Gestion budgétaire et dépenses publiques*, Presses de l'Université du Québec, 2009.

21 *Ibid.*, page 202.

## Program Performance Assessment: Drawing on the American Model

**The Program Assessment Rating Tool (PART)**

The United States Office of Management and Budget is a federal agency whose mission is to provide the President with support in preparing the budget and spending plans. It also sets budget priorities and monitors compliance with rules and standards of financial management in the public administration.

In 2002, the agency developed PART to measure the management and performance of federal public programs. Using a questionnaire of 25 common questions to which specific questions can be added depending on the nature of the program, PART can assess the performance of programs and assign them a ranking.

Among programs whose performance is acceptable:

- Programs that are rated "Effective" have stipulated ambitious objectives, are able to assess the results achieved, are managed rigorously and include measures for improvement.
- Programs that are rated "Moderately Effective" have clear objectives and are adequately managed. However, improvements must be made regarding results or their structure.
- Programs rated "Adequate" need to improve the definition of their objectives, obtain better results or improve their management practices.

As for other programs:

- Programs are rated "Ineffective" if they make poor use of public funds, either because they have no clear objectives, fail to achieve the expected results or are poorly managed.
- A program is rated "Results Not Demonstrated" if it does not have objectives and performance indicators that allow it to be assessed under the PART model.

**Improved performance of public programs**

At the end of fiscal year 2008, 1 015 programs had been assessed, i.e. 98% of all programs of the American federal government.

Of these, only 20% were found ineffective, compared with 55% in the first assessment year, 2002, when a sample of 234 programs was assessed.

Source: Office of Management and Budget, Executive Office of the President of the United States.

## ❑ INESSS: an opportunity that must not be wasted

The government may soon have a very valuable tool for assessing performance in the health sector, with the implementation of the Institut national d'excellence en santé et en services sociaux (INESSS). Whether the bill currently being examined by the National Assembly indeed will allow the new institute to play such a role is another matter.

### ■ Adaptation of the United Kingdom's NICE to Québec's needs

The idea of setting up an institute devoted to excellence in the health sector stems from the report of the Task Force on the Funding of the Health System.[22] It draws directly on the experience of the National Institute for Health and Clinical Excellence (NICE) in the United Kingdom.

— NICE was set up in 1999. It is an independent organization with responsibility for providing advice and expertise in the field of health promotion, prevention and treatment of sickness. The organization is now cited as an example throughout the world.

— The idea formulated by the Task Force on the Funding of the Health System is to set up and equivalent organization in Québec, starting from the Conseil du médicament du Québec and the Agence d'évaluation des technologies et des modes d'intervention en santé – with the goal of helping build a productive and efficient health system.

In late 2009, the Minister of Health and Social Services tabled a bill creating the Institut national d'excellence en santé et en services sociaux.

The report of the Task Force on the Funding of the Health System emphasized a key item: INESSS must have the capacity to assess the performance of existing programs, in order to provide the government with proposals to better manage the basket of services.[23]

However, this strategic element is missing from the bill tabled in the fall.

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22 *Getting Our Money's Worth, op. cit.*, page 212.

23 This recommendation was taken up by the implementation committee of the Institut national d'excellence en santé et services sociaux (also chaired by Claude Castonguay). See Institut national d'excellence en santé et services sociaux (INESSS), *Rapport du comité d'implantation de l'Institut national d'excellence en santé et services sociaux (INESSS)*, Québec, 2008, page 83.

This significant initiative of the Minister of Health and Social Services must go further: as the report of the Task Force on the Funding of the Health System advocated, the government must take the right legislative steps to have an organization dedicated to introducing more effective ways of defining our basket of services in the health and social services field. The new organization must have a mandate to assess some of the ways health dollars are spent, and thus contribute to efforts to ensure that public funds are spent as effectively as possible.

### INESSS: An Omission That Must Be Remedied

**A recommendation of the Task Force on the Funding of the Health System**

The Task Force on the Funding of the Health System recommended, in its report released in February 2008, the creation of the Institut national d'excellence en santé (INES). This independent and credible organization would combine the Conseil du médicament du Québec, the Agence d'évaluation des technologies et des modes d'intervention en santé and the Commissaire à la santé et au bien-être. It would be mandated to assess the relevance and quality of health services. More specifically, the Institute would, in particular:

- periodically make recommendations on the composition of the basket of services insured by the public system;
- assess new health technologies, including drugs, to recommend their inclusion on the list of insured drugs or in the basket of insured services;
- review whether technologies and drugs currently covered should continue to be included in the list of insured drugs and the basket of insured services;
- monitor new technologies and new forms of intervention that appear on the market to identify the most relevant;
- produce clinical protocols and practice guides.

**A key item omitted**

Following up on the recommendation of the report, the government tabled, last November 12, Bill 67 to create INESSS.

However, a key item of the organization's mandate, namely the introduction of a process to review the basket of publicly insured services, was not included. And yet, the idea of introducing this type of mechanism is not new, since the Clair report had also recommended it in 2001.

### 1.2.2 Second principle: encourage good management, sanction poor management and allow competition

The second principle the committee is formulating stems from a well-known reality: emulation is the key to success, and this reality applies directly to the efficient use of public funds.

#### ❑ Financial incentives or competition

Emulation can have two sources:

— It can result from financial incentives for managers or organizations. In the latter case, we are referring to the possibility for the organization to retain the gains made, in order to use them for priorities it defines.

— It may also stem from competition, i.e. placing the public organization in competition with private organizations, whether for-profit or not-for-profit.

The OECD has done work leading to very clear conclusions on this matter.[24]

— Public agents need to be motivated to be more attentive to public service missions and results.

— Some governments have taken an accounting approach based on auditing and setting explicit objectives.

— Other administrations prefer a more economical approach that in particular consists in introducing competition to bolster efficiency.

#### ❑ The example of the Netherlands

There are thus many ways to encourage good management and reward performance in the delivery of public services. A reform of the health system introduced by the Netherlands in 2006 provides an example of what can be done when competition is brought into play:

— Competition is used to ensure better delivery of services. It is to be noted that service providers are put in a situation of competition, but this principle also applies to insurers.

— In accordance with the funding by activity rule, the money follows the patient.

— The state plays the role of regulator and maintains social coverage.

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24 OECD summary, *Public Sector Modernisation: Governing for Performance*, OECD, December 2004.

## The Health System in the Netherlands: Competition Within Limits

**The health system reformed to allow competition within limits**

In 2006, the Dutch government carried out a broad reform of its health system to allow competition within limits. Instead of a system centrally-planned by the government, the Netherlands opted for a system in which competing insurers purchase health care from providers of care that compete among themselves, which stimulates efficiency and quality in the supply of services to the insured and the patient. In this system, the state acts as a regulator to guarantee quality care for all, but does not provide any medical service itself.

- Hospitals and other private service providers have broad freedom and responsibility to compete, which encourages them to provide better service.
- Insurers also compete to attract insured persons and negotiate with service providers to obtain the best service for their members.
- Individuals have more financial responsibility, but they have greater influence over the development and quality of care as a result of being able to change insurer.
- Public authorities remain responsible for accessibility, affordable pricing and quality of health care.

According to the Dutch government, the new health system strikes a balance between solid social coverage and a dynamic market.

**Competition within limits that protects and favours patients**

All citizens are required to obtain health insurance from a private insurer recognized by the government. They obtain basic insurance and can purchase supplemental insurance offering more latitude. Insurers can earn profits but do not have the right to refuse to issue contracts to applicants. A risk-spreading system covers insurers for the high cost of care for insured persons who are chronically ill. The government also provides a health care allowance for moderate-income persons.

**Funding provided entirely by private insurers**

The health system is funded by flat premiums independent of risk (50%) and by premiums tied to income and collected at source (45%). General taxes provide only 5% of funding. The amounts thus collected are paid to the insurers under the risk offset system. In this way, all health system funding passes through the hands of private insurers that seek to obtain efficient medical services that meet the needs of patients.

**The Dutch value their health system highly**

In 2009, for the second year in a row, the Netherlands ranked first in the annual assessment of health care systems in Europe as carried out by the Euro Health Consumer Index. The Euro Health Consumer Index assesses the overall performance of health systems from the patient's standpoint. It has 38 health service quality indicators divided into six categories: patient rights and information, telehealth, e-health, waiting times for treatment, results, the scope and breadth of services provided, and drugs.

## ❑ Reward or sanction as part of budget-making

Good management can also be rewarded, and poor management sanctioned, as part of budget-making: the allocation of resources reflects results obtained and favours good managers.

As seen previously, in Québec, existing budget-making practices in the health sector consist in allocating budgets on a historical basis, taking the composition of client groups into account. There is little or no link between budget-making and performance.

### ■ Legislation that is not followed in the health sector

Worse still, poor management and the resulting deficits are not sanctioned, even though the legislation explicitly stipulates balanced budgets. Such is the case with the Act to provide for balanced budgets in the public health and social services network, which the government passed in 2000.

— The legislation explicitly stipulated that a public institution of the health and social services network could not post a deficit during a fiscal year.

— By passing this restrictive provision, the government simultaneously erased all the deficits accumulated by hospitals at the time, i.e. $800 million for 1998-1999 and $545 million for 1999-2000.

— New deficits have been incurred since and have entailed no negative financial or disciplinary consequences for the managers responsible for them.

### ■ A credibility issue

This is a credibility issue: without sanctions, the signal sent to managers is very weak.

— Poor management is not really considered blameworthy, since there are no practical consequences for the funding or operation of the organization incurring a deficit.

— On the contrary, government practice is to regularly erase deficits resulting from such poor management, which can only de-motivate good managers whose efforts have made it possible to stay within the budgets allocated.

## ❑ The experience of government agencies

For about ten years, the Québec government has attempted to improve management transparency and motivation by making government agencies, like the Régie des rentes du Québec, responsible for certain programs and public services. These agencies are not to be confused with regional agencies mentioned regarding the health sector, or school boards, referred to in our discussion of the education sector.

### ■ The underlying philosophy

The philosophy underlying the creation of government agencies should enable the funds allocated to public services placed under their responsibility to be spent more effectively.

By creating government agencies, the Québec government is isolating the organizations mandated to deliver certain services, which also allows:

— more autonomy for these organizations;

— a direct relationship between the cost of services and how they are funded;

— rigorous accountability, by assessing results and measuring performance.

The government allows these agencies a measure of freedom compared to government departments (retention of the revenue they generate, flexibility in human resources management, possibility of carrying over unused funding).

## ■ An analysis of the performance of certain agencies

A 2009 study[25] provides an example of the information that can be obtained regarding the financial performance of a number of Québec government agencies.

TABLE 3

**Analysis of productivity in certain Québec agencies**
(2001-2002 to 2006-2007)

| | Workforce (FTE)[1] | Rank among agencies studied (out of 15) | Annual growth in unit costs (%) | Average annual productivity (%) |
|---|---|---|---|---|
| Income security[2] | 5 671 | 11 | – 3.20 | 2.33 |
| Emploi-Québec | 4 484 | 13 | – 0.78 | – 5.96 |
| Régie des rentes du Québec | 1 121 | 5 | 0.30 | 1.12 |
| Centre de perception fiscale[2] | 1 079 | 7 | 3.30 | – 5.05 |
| Aide financière aux études | 344 | 9 | 0.90 | n/a |
| Bureau des infractions et amendes | 141 | 14 | 9.96 | – 9.08 |
| Centre de conservation du Québec | 30 | 4 | – 3.14 | 1.18 |
| Centre d'expertise en analyse environnementale du Québec | 107 | 12 | – 0.68 | 0.04 |
| Centre de gestion des équipements roulants | 410 | 10 | 3.26 | – 1.08 |
| Centre de recouvrement du ministère de l'Emploi et de la Solidarité sociale | 238 | 2 | – 3.28 | 5.36 |
| Centre de signalisation | 30 | 15 | 54.86 | – 11.04 |
| Laboratoire de sciences judiciaires et de médecine légale | 137 | 1 | – 4.30 | 4.36 |
| Commission administrative des régimes de retraite et d'assurance | 441 | 6 | – 1.36 | 3.64 |
| Régie du cinéma | 43 | 3 | – 5.54 | 20.40 |
| Service aérien gouvernemental | 162 | 8 | – 3.10 | 2.44 |
| **Overall results** | **14 438** | – | **0.75** | **– 0.29** |

1 Full-time equivalent.
2 For these agencies, the study period ends in 2005-2006.

25 Claude Laurin, Marie-Ève Quenneville and Nicole Thibodeau, *The Long-Run Performance of Decentralized Agencies in Québec*, HEC Montréal, Centre sur la productivité et la prospérité, September 2009.

The existence of qualitative and quantitative information on a certain number of financial and management indicators enabled researchers to measure the overall performance of these agencies, in particular by using service production, financing and productivity criteria.

The research indicates that results vary with the size, management autonomy and nature of the agencies. Other analyses would shed more light on the variations.

Rather unexpectedly, the information enabled the authors to rank these agencies on the basis of performance. While smaller agencies performed better than larger ones overall, the Régie des rentes du Québec ranked first among agencies with more than 250 employees.

On the whole, there was little change in productivity during the period. However, productivity did improve in almost 65% of cases (9 out of 14).

### ■ Experience heading in the right direction

The committee feels it is important to mention the experience of the agencies because it is heading in the right direction: it is possible to introduce more autonomy and performance stimulation while remaining within the public perimeter.

The concept of agencies has an additional advantage: it offers observable results, and thus a credible performance assessment.

## Fundamental principles

The two principles mentioned earlier are fundamental in the committee's view.

— Spending will not become more effective without a more credible and objective program performance review process being implemented. Program performance assessment must be generalized and depoliticized.

— Moreover, it is absolutely essential to implement mechanisms to encourage good management, identify and sanction poor management, and allow competition.

These two principles should dictate the changes, major ones in some cases, to be made to how we spend public funds.

They would be implemented within comprehensive rules concerning the budget, whose application they would facilitate – simple rules concerning balanced budgets, with which Québec is currently familiar, or more sophisticated ones such as those applied in a number of European countries.

The committee is therefore convinced that it is indeed possible to spend more effectively and thus meet part of the daunting public finance challenges we face.

# PART TWO

## Can we better fund our public services?

The second part of this document examines the revenues that the state collects to fund public services.

The question leads us to consider two different problems, each of which is covered in a separate section:

— The committee first considered the conditions of a **more efficient tax system**, defined in such a way that the damaging impact on economic development is minimized.

— The committee then turned to the topic of **fees**, studying the impact of fees on the funding of public services.

As with spending, the committee begins by explaining the sense of the question it has raised in a short introduction.

## A STRATEGIC QUESTION GIVEN THE AMOUNT OF TAX WE PAY

The question posed by the committee concerning the funding of our public services is just as important as the question raised earlier regarding spending, and for a similar reason: we are compelled to levy more taxes than elsewhere to fund our public services. We must therefore be particularly effective in the definition of our tax system.

The large amounts we collect through taxes must prompt us to be very attentive to their impact on economic growth and on the behaviour of users of public services.

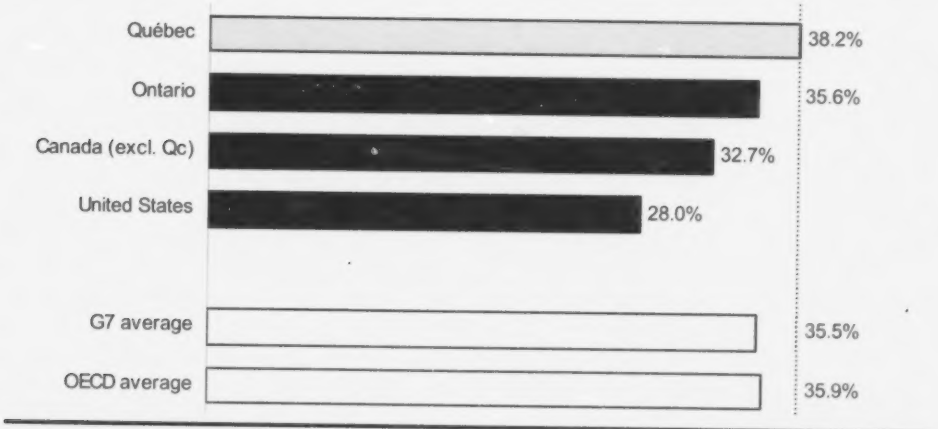
Shown below are two charts taken from the committee's first document. They illustrate the amounts of our tax revenues and our gross debt.

### ❑ The weight of fiscal levies

Total tax revenue collected in Québec in 2006 represented just over 38% of GDP, compared with less than 36% in Ontario, 33% in Canada excluding Québec and 28% in the United States.[26]

CHART 1

**Total tax revenues – 2006**
(as a percentage of GDP)




Sources: OECD and ministère des Finances du Québec.

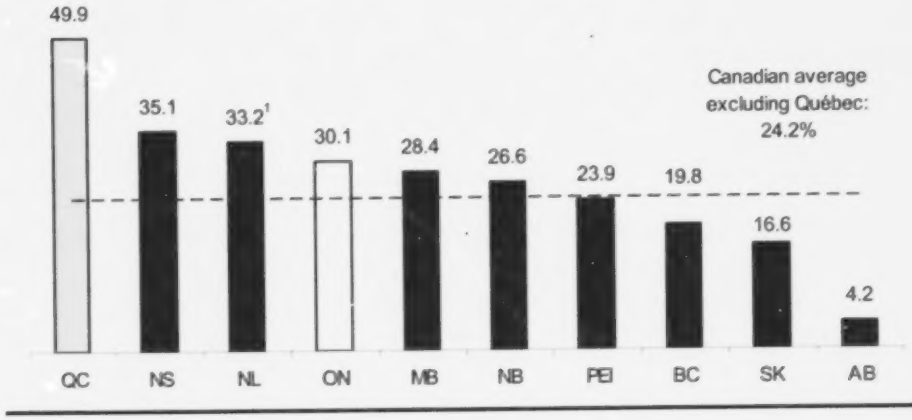
26 See *Québec and Its Challenges, Document 1*, op. cit., page 24.

## ❑ The debt

These high taxes have not been enough to cover the cost of public services, and we have had to incur debt – in large part to cover current spending.[27]

CHART 2

**Gross debt of the Canadian provinces as at March 31, 2009**
(as a percentage of GDP)




1 As at March 31, 2008.
Source: Ministère des Finances du Québec.

## ❑ The distribution of taxes, the need for user fees

To answer the question concerning the funding of our public services, the committee studied two problems:

— the distribution of taxes, in order to make **taxation more efficient**;

— **greater use of user fees**, in order to influence the behaviour of users of public services and that of the government.

The committee's analysis of these two problems prompted it to formulate **two principles** that, if implemented, would improve the funding of our public services.

27 *Ibid., page 32.*

## 2.1 MORE EFFICIENT TAXATION

We can improve the funding of our public services by defining an efficient tax system that does not compromise our economic development.

To understand what is required in this regard, the impact of taxes on economic growth must be emphasized, before studying the situation of taxation in Québec in relation to this criterion.

### 2.1.1 The impact of fiscal levies on economic growth

Any levy on an individual, whether a tax or fee, has a negative impact on economic growth. As soon as the state collects a dollar, that is one less dollar available to individuals or businesses to spend, save or invest. Taxes and fees thus have a negative long-term impact on economic growth.

However, this impact depends on the nature of the levy.

#### ❑ The long-term cost to economic growth of taxes and fees

The analyses conducted by the ministère des Finances confirm, in the case of Québec, a well-known phenomenon: user fees and consumption taxes have less negative impact on wealth creation than other forms of levies. These analyses corroborate studies conducted on the same topic by the OECD.[28]

— In practical terms, that means that a $1-billion increase in personal income tax reduces real GDP by $0.8 billion.

— However, if that same $1 billion is raised through consumption taxes, real GDP is reduced by only $0.3 billion.

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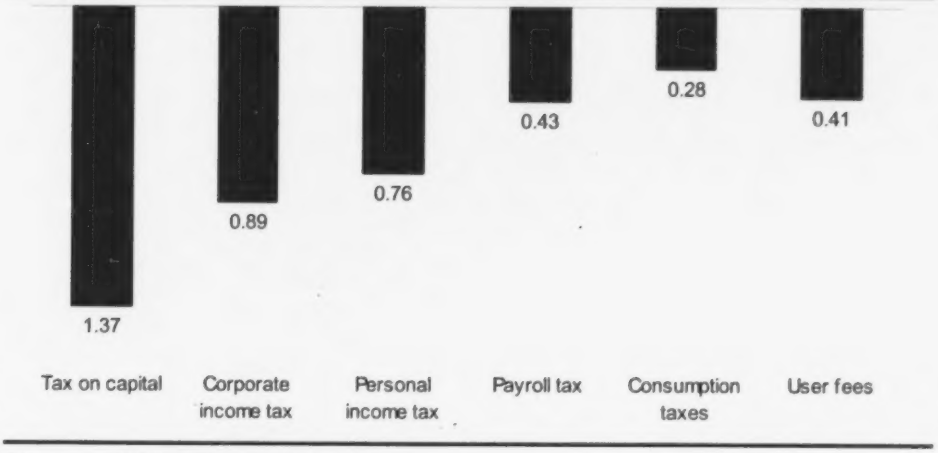
28 OECD website:
http://www.oecd.org/document/17/0 3343,en_2649_34533_39495761_1_1_1_1,00.html

CHART 3

**Long-term cost to Québec's real GDP of each $1-billion increase in taxes and user fees**
(billions of dollars)




Source: Ministère des Finances du Québec.

## ❑ The damaging nature of income tax

The results obtained by the ministère des Finances are not surprising.

Personal and corporate income taxes and the tax on capital are very damaging to wealth creation, because the very sources of wealth creation, namely work, savings and investment, are penalized.

— By taxing work, the incentive to work is diminished and workers who want to work more are discouraged from doing so.

— By taxing savings, the incentive to save and thus fund investments is diminished.

These income taxes are all the more damaging since they have repercussions on the cost of products and services and make them less competitive on export markets.

### ❑ Consumption taxes avoid such damage

These undesirable impacts are avoided when consumption is taxed.

The taxpayer can reduce his tax burden by reducing his consumption.

— Reducing consumption allows savings to grow, which favours investment financing.

— Consumption taxes apply to all products sold on the market where the tax is collected, including imported products.

— Exported products are exempted. Consumption taxes have no effect on our competitiveness on export markets.

— Consumption taxes help improve the integrity of the tax system because, in general, they are much less subject to tax evasion than income taxes.[29]

There is one disadvantage to consumption taxes: when applied uniformly, they place a heavier burden on the most disadvantaged. Accordingly, they must be accompanied by measures to protect those in greatest need, measures such as zero-rating basic products and services, and the Québec sales tax credit.

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29 On this subject, see : Ministère des Finances du Québec, Economic, Fiscal and Budget Studies, *Tax Evasion in Québec – Its Sources and Extent*, April 2005.

## 2.1.2 The distribution of taxation in Québec is not efficient

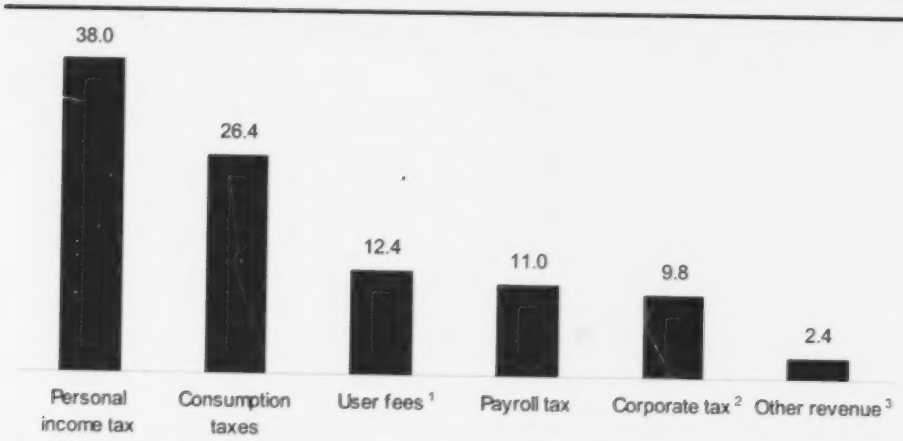
The analysis of the distribution of taxes in Québec reveals that the distribution could be more efficient from the standpoint of economic growth: the weight of different taxes is not geared to maximize growth.

— Personal income taxes account for the largest share of our own-source revenue, i.e. nearly 40%. They are also among the most damaging to economic growth.

— On the other hand, we make less use of consumption taxes and user fees, whose impact on economic growth is much smaller.

CHART 4

**Distribution of own-source revenue excluding government enterprises - in 2007-2008**
(per cent)




1 Including revenues from user fees of government departments, organizations and networks.
2 Including the tax on capital.
3 Includes interest income, penalties and fines.
Source: Ministère des Finances du Québec.

## ❑ A structural problem

There exists a structural problem in how we distribute taxes. It must be pointed out that this problem is not specific to Québec: Ontario and Canada as a whole have the same tax structure.

In developed countries, there is a correlation between the size of public spending, the amount of fiscal levies and the role played by consumption taxes:

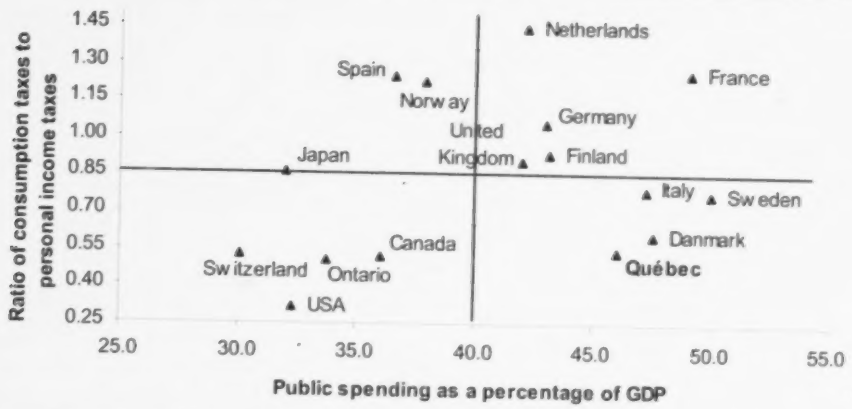
— In countries with an extensive social safety net, such as European countries, consumption taxes generally account for the largest share of government revenues.

— On the other hand, in countries with a smaller social safety net, like the United States, direct taxes on personal income are preponderant.

Compared to other developed countries, Québec's situation seems paradoxical.[30]

CHART 5

**Level of public spending and ratio of consumption taxes to personal income taxes**
(percentage points)




Source: Ministère des Finances du Québec.

— We are part of the group of jurisdictions where public spending is among the highest as a percentage of GDP.

30 The table showing the data reproduced in Chart 5 can be found in Appendix 2, page 91.

— But our tax structure is similar to that of jurisdictions where the social safety net is the least extensive. Only Denmark appears to be in a situation close to ours.

## ❑ Recent efforts to improve the distribution of our taxes

In recent years, significant efforts have been made in Québec to limit the consequences of this structural problem.

The harmful effects on economic growth of the tax on capital explain why this tax is being eliminated in Québec – after most jurisdictions.

Other initiatives taken in the past by the Québec government also seem to be headed in the right direction.

— The committee is referring to the reduction in direct taxes and the upcoming rise in the QST, announced in 2007 and 2009 by the current government.

— The committee also notes the tax reform, under Finance Minister Landry, implemented by the Québec government in the late 1990s under the authority of Premier Lucien Bouchard.

**The Personal Income Tax Reform of the Late 1990s**

In the 1997-1998 budget, then Minister of Finance Bernard Landry announced an overhaul of the personal income tax system. Acknowledging the weight of Quebecers' tax burden and the harmful effects of income tax on the incentive to work and save, the reform had to be revenue-neutral given the government's budget deficit situation.

Such was the context in which a personal income tax reduction of $850 million was announced. The tax cut was to be funded by raising the rate of the Québec sales tax rate from 6.5% to 7.5%. This change to the tax structure was designed to further move the fiscal levy towards taxes that are less harmful to economic growth. In that regard, Mr. Landry said:

> "Personal income tax is overused in the Québec taxation system. Québec personal income tax is the highest in Canada. Indeed, it exceeds the level attained in all the G7 nations.
>
> Such a tax burden is undermining our competitiveness and gradually draining our ability to maintain social justice. The reform of taxation that I am announcing today focuses primarily on the recommendations of the Commission on Taxation and the Financing of Public Services, that is:
>
> - better gearing taxation to jobs;
> - reducing taxpayers' overall tax burden once we eliminate the budget deficit; [...]."

## ❑ An imperative: do not raise income taxes

Despite these initiatives, our tax system still relies too heavily on direct taxes, especially personal income tax, while the weight of our levies is similar to that in Europe. We can thus speak of a "Québec paradox".

In the current context, that means that above all, income tax must not be raised:

— the impact on wealth creation would be extremely damaging, especially in the context of demographic changes and their effects on the labour market;

— we must take every means available to foster wealth creation.

## ❑ A requirement: inequalities must not grow

At the same time, and this is essential, greater use of consumption taxes must not be allowed to exacerbate inequalities in our society.

The examples from Sweden in particular show that this can be achieved, thanks to spending and transfer programs that benefit low-income individuals. Accordingly, consumption taxes can be used more extensively, without increasing income inequalities, by bringing our redistribution programs to bear.

## 2.2 RELY MORE EXTENSIVELY ON USER FEES

There is a second way to better fund our public services: by more extensive application of user fees. User fees have a number of advantages that should be mentioned here, before assessing how such fees are used here compared to Ontario.

### 2.2.1 The advantages of user fees

As we have seen earlier, user fees are a less damaging form of levy for economic activity.

#### ❑ User fees foster good behaviour

User fees foster good behaviour, both by those who use services and by governments that offer them. The question of user fees was extensively studied in 2007-2008 by the Task Force on Fees for Public Services chaired by Claude Montmarquette.[31]

— User fees ensure good services, provided, of course, the additional revenue generated by an increase in fees is in fact allocated to an improvement in the services for which the fees are charged.

— There is a direct link between fee and efficiency. The user of the good or service can correctly assess the value of the good or service he receives. Without a price paid by the user, there is frequently over-consumption or waste of the good or service. The example of water and of the impact of not charging for it is very enlightening in this regard.

— User fees can also have a positive influence on behaviour and contribute to better use of infrastructures (time-differentiated fees for road tolls to reduce traffic congestion, by encouraging some users to drive at different times, for instance).

— Lastly, it should be pointed out that user fees raise the question of whether the public service is relevant.

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31 See the report of the Task Force on Fees for Public Services, *The Right Fees to Live Better Together*, March 2008, page 32.

## The Policy for the Funding of Public Services

The government released the Policy for the Funding of Public Services in March 2009, as part of the 2009-2010 Budget. Through better fee-setting practices, the policy aims to improve funding of public services to maintain their quality, accessibility and long-term viability.

The goal of the policy is to secure the long-term viability of public services as well as their accessibility, to improve Quebecers' well-being. It introduces better fee-setting practices in public organizations offering services for users, by defining and framing their fee-setting processes.

**Principles**

The policy is based on the following principles:

- the rigour of the method of funding the services that the government offers, in particular through a knowledge of the cost of fee-based services, the enhancement of services and the evaluation of public policies that include a user fee component;
- the efficiency and fairness of resource allocation, in particular by means of the allocation of user fee revenues to fee-based services and recognition of the financial capacity of low-income households;
- transparency, in particular from the standpoint of the availability of information on the funding process and the obligation to achieve accountability, for the sake of striking a balance between reasonably accurate details and the desired informational objective.

**Actions**

Application of the policy to government departments and organizations encompasses five actions:

- establish the method of funding public goods or services, whether by user fees or general revenues, taxes in particular;
- determine the costs of current and potential fee-based services;
- set fees and index them annually within the existing regulatory and legislative framework, based on the established self-financing target;
- allocate the amounts paid by users to the funding of fee-based services;
- ensure accountability for fee-setting practices.

In addition, the policy stipulates the implementation of compensatory measures to ensure low-income households have access to essential services.

**Bill respecting the funding of public services**

As mentioned in the policy, a bill is expected to frame fee-setting policies. The legislation will enable the government to ensure that the policy's principles are applied in all public organizations, to enable efficient and fair funding of public services.

## 2.2.2 We rely less extensively on user fees than neighbouring jurisdictions

Normally, our extensive system of public services should prompt us to make greater use of user fees than elsewhere. In Québec, many private services are funded collectively.[32] Examples include daycare service, prescription drugs, universities and part of the insurance relating to the use of automobiles.

However, there is another trait specific to Québec: given the scope of private services that are publicly funded, we make little use of user fees.

### ❑ A comparison between Québec and Ontario

The data show clearly that we make much less use of user fees than Ontario and the rest of Canada, despite the scope of our public services.

Comparing Québec's situation with that of Ontario, the figures are as follows.[33]

— In 2007-2008, revenues from user fees were $6.8 billion less in Québec than in Ontario.

— Most of the difference is attributable to electricity rates ($3.4 billion).

— There are also differences for government departments, organizations and networks ($1.1 billion) and for daycare services ($1.4 billion).

— The difference amounts to $1.2 billion in the education network. Most of that is attributable to tuition fees ($0.7 billion).

— There is a significant difference attributable to prescription drug insurance ($0.6 billion).

32 These are private as opposed to public services by nature, such as defence, justice, international affairs or components of public health like vaccination against the A(H1N1) flu virus.

33 Detailed explanations of the data given in Table 4 are provided in Appendix 3, page 93.

TABLE 4

## Revenues from user fees of organizations under the authority of the Québec government - Difference compared to Ontario - 2007-2008

(millions of dollars)

| | 2007-2008 | | |
|---|---|---|---|
| | Québec's revenues | Difference compared to Ontario | |
| | | ($ millions) | ($ per capita) |
| Departments, organizations and networks | | | |
| Departments, organizations and special funds | 2 963 | – 464 | – 60 |
| Health network | 1 345 | 292 | 38 |
| Education network[1] | 1 790 | 1 246 | 162 |
| **Subtotal – Departments, organizations and networks** | **6 098** | **1 072** | **140** |
| Other sources of fees | | | |
| Electricity rates (Hydro-Québec) | 10 368 | 3 388 | 441 |
| $7 daycare services[2, 3] | 512 | 1 386 | 181 |
| Insurance: | | | |
| Occupational health and safety insurance (CSST) | 2 278 | 328 | 43 |
| Prescription drug insurance | 1 350 | 630[4] | 82 |
| Other insurance (parental, automobile and farm) | 2 132 | NA | NA |
| **Subtotal – Other sources of fees** | **16 640** | **5 732** | **747** |
| **TOTAL** | **22 738** | **6 804** | **887** |

1 Higher education and school boards.
2 Early childhood centre, family daycare and school daycare.
3 Because of recent data not available in Ontatio, the difference is calculated compared to the Canadian average, excluding Québec and Ontario.
4 Public spending on prescription drugs. The difference is attributable to the broader coverage of Québec's plan in addition to lower fees. (Source: Canadian Institute for Health Information.)

NA: Not applicable.

Sources: Ministère des Finances du Québec. The differences compared to Ontario for departments, organizations and networks are calculated using data from Statistics Canada's Financial Management System.

## TWO MORE PRINCIPLES

The second question raised by the committee concerning the funding of public services leads to an affirmative answer: we can indeed better fund our public services.

To do so, we must apply two principles that are, in a way, symmetrical with the principles identified for spending.

### ❑ Improve the distribution of fiscal levies

We must distribute fiscal levies by giving preference to taxes that are least damaging to economic growth – i.e. consumption taxes in particular.

— This is crucial for a jurisdiction like ours, where the significant supply of publicly-funded public services leads to a heavier tax burden than elsewhere.

— We will thus minimize the impact of taxation on wealth creation.

— Regarding consumption taxes, mechanisms must be set up to mitigate the impact of these levies on the less affluent.

### ❑ More extensive application of user fees

We must also apply user fees more extensively to fund our public services.

— Here again, this general principle is particularly applicable in Québec, because its public services are more extensive than elsewhere.

— Greater use of fees reduces the pressure of direct taxation.

— Above all, it leads to good behaviour by users of public services, by establishing a direct and transparent link between the use of the service and its cost for the one benefiting from it.

— For fees as for taxes, the use of this type of funding must be accompanied by measures protecting individuals in greatest need.

# Conclusion

At the end of the second stage of its work, the committee has come to one major conclusion: given the large amounts of our spending and our taxes, we must give priority to efforts to spend more effectively and better fund our public services.

— We can spend more effectively, i.e. make better use of the funds allocated to funding public services.

— We can also better fund our public services.

## ❑ A source of hope

That is a source of hope: it means that by learning from what has been done elsewhere – in some cases for a long time – it is possible to reduce the cost of existing services or provide more for the same cost.

In the health sector, there are very specific examples of ways of doing things that cost money and reduce what we get compared to what we pay. That is also true in the education sector, as well as in large commercial corporations like Hydro-Québec.

At the same time, we can improve the funding of our public services by defining an efficient tax system that does not compromise our economic development, and by making greater use of user fees to fund public services, as is done in countries offering significant services that are collectively funded.

## ❑ Simple principles

We can achieve this by applying a number of simple principles.

### ■ Program performance assessment must be generalized and depoliticized

— Québec needs regular, systematic and credible performance assessment of existing programs.

— This assessment must have an impact on how money is spent and on budget-making.

- **Good management must be encouraged, poor management sanctioned and competition must be allowed.**

— Emulation is the key to success in the efficient use of public funds.

— Such emulation can stem from financial incentives for managers or organizations, or from competition.

- **We must define an efficient tax system and thus reduce the negative impacts of all taxes on economic development**

— We absolutely must avoid raising income taxes, especially in the context of demographic changes and their effects on the labour market.

— We must shift fiscal levies towards forms of taxation that are least damaging to economic growth. i.e. consumption taxes in particular.

— In doing so, we must prevent the use of consumption taxes from causing inequalities within society to grow.

- **Apply user fees more extensively**

— In doing so, we will foster good behaviour, both by the user of the services and by the government that offers them.

— The funding of services will thus enable more effective spending.

— As with consumption taxes, measures must be defined to protect those in greatest need.

### ❑ Concrete initiatives

These principles can quickly lead to concrete initiatives, such as:

— a clear choice between the centralized approach and regionalization in the management of our health and education systems;

— generalization of activity-based funding in the health sector;

— development of the opportunities offered by competition in the health sector, mirroring what is already done in the education sector;

— application to commercial government corporations – beginning with Hydro-Québec – of quantified performance requirements, defined on the basis of a comparison with results from other jurisdictions;

— adoption of comprehensive budget rules defining multi-year and sector-based targets;

— implementation of a systematic program performance assessment process;

— establishment of an assessment process for the basket of public services in the health sector, making full use of the future Institut national d'excellence en santé et services sociaux;

— effective application of the Act to provide for balanced budgets in the public health and social services network to hospitals and CSSS;

— if fiscal levies need to be raised, doing so through consumption taxes rather than income tax;

— greater application of user fees, applying the principles and the process defined in the Policy for the Funding of Public Services.

The committee is confident that we can meet the economic and public finance challenges facing us.

Much can be done without calling the basket of public services Québec offers into question.

We can spend more effectively and better fund our public services. However, to do so, we must make choices and take action.

# The committee's impending deliberations

Keeping to the plan laid out when it began working, the advisory committee on the economy and public finances will complete its work by submitting a third document to the government with a variety of options concerning revenue, spending and debt, in a context of wealth creation.

# Appendix 1 – Members of the Advisory Committee on the Economy and Public Finances

## ❑ Robert Gagné (co-chairman)

With a doctorate in economics from the Université de Montréal, Robert Gagné is a professor at HEC Montréal and the director of the Centre sur la productivité et la prospérité.

Robert Gagné specializes in applied econometrics, industrial organization and public policy. In recent years, Robert Gagné chaired the Task Force on Tax Assistance for the Resource Regions and the New Economy and co-chaired the Advisory Committee on the Fiscal Imbalance of the Council of the Federation.

In 2002, Mr. Gagné was appointed a regular member of the Centre interuniversitaire sur le risque, les politiques économiques et l'emploi (CIRPÉE). Since 1999, Robert Gagné has been a member of the Centre interuniversitaire de recherche en analyse des organisations (CIRANO). He has focused on researching issues relating to business productivity, resource optimization and issues relating to the transportation sector.

## ❑ Pierre Fortin (member)

Pierre Fortin holds a doctorate in economics from the University of California, Berkeley, and a master's in mathematics from the Université de Montréal.

He is professor emeritus in the economics department of the Université du Québec à Montréal (UQAM). His research focuses chiefly on economic growth, monetary and budgetary policy, social policy and the economy of Canada and Québec.

He is a member of the Royal Society of Canada and of the science council of the Canadian Institute for Advanced Research. He has been President of the Canadian Economics Association, a member of the panel of economic advisors of the Minister of Finance of Canada and senior economic advisor to the Premier of Québec.

### ❑ Luc Godbout (member)

Luc Godbout holds a doctorate from the Université Paul-Cézanne-Aix-Marseille III. He is an associate professor at the Université de Sherbrooke.

He specializes in taxation and public finance. In recent years, he has, in particular, been a member of the Task Force on Tax Assistance for the Resource Regions and the New Economy, in addition to contributing to the Commission on the Fiscal Imbalance.

Luc Godbout is also a researcher with the Research Chair in Taxation and Public Finance of the Université de Sherbrooke. His research has focused in particular on the consequences of the aging of the population on Québec's public finances. Since 2006, Luc Godbout has co-directed four books published by the Presses de l'Université Laval. He is the author of a monthly column, "Les public finances sous la loupe", published by *La Tribune*.

### ❑ Claude Montmarquette (member)

Claude Montmarquette holds a doctorate in economics from the University of Chicago. He currently holds the Bell - Caisse de dépôt et placement du Québec chair in experimental economics at the Université de Montréal, as professor emeritus.

Claude Montmarquette is President and CEO of the Centre interuniversitaire de recherche en analyse des organisations (CIRANO), where he heads the public policy research group. Claude Montmarquette has been a guest professor at many foreign universities and is a regular participant at a large number of conferences and seminars around the world.

# Appendix 2 – Comparison among certain jurisdictions of the use of consumption taxes as a proportion of personal income tax

TABLE 5

**Ratio of consumption taxes as a proportion of personal income tax**
(per cent)

| | Public spending as a % of GDP | Income tax as a % of total revenue[1] | Consumption taxes as a % of total revenue[2] | Ratio of consumption taxes to personal income tax |
|---|---|---|---|---|
| Sweden | 50.00 | 31.90 | 24.63 | 0.77 |
| France | 49.10 | 17.55 | 22.16 | 1.26 |
| Denmark | 47.60 | 49.95 | 30.45 | 0.61 |
| Italy | 47.30 | 25.38 | 20.07 | 0.79 |
| **Québec[3]** | 46.10 | 31.24 | 16.82 | **0.54** |
| Finland | 43.20 | 30.35 | 28.25 | 0.93 |
| Germany | 43.00 | 24.49 | 25.79 | 1.05 |
| Netherlands | 42.20 | 18.79 | 27.11 | 1.44 |
| United Kingdom | 42.00 | 28.97 | 26.27 | 0.91 |
| Norway | 37.90 | 20.67 | 25.29 | 1.22 |
| Spain | 36.60 | 18.55 | 23.09 | 1.24 |
| Canada | 36.10 | 36.07 | 18.65 | 0.52 |
| **Ontario[3]** | 33.80 | 34.01 | 17.28 | **0.51** |
| United States | 32.30 | 36.24 | 11.49 | 0.32 |
| Japan | 32.00 | 18.46 | 15.82 | 0.86 |
| Switzerland | 30.10 | 35.60 | 18.70 | 0.53 |

1 OECD data for 2006, personal income tax (account 1100 of Revenue Statistics - Comparative tables).
2 OECD data for 2006, total of taxes on goods and services and excise taxes (accounts 5110 and 5121 of Revenue Statistics - Comparative tables).
3 The data are from Statistics Canada's provincial economic accounts including those for all public administrations. (November 2009 update).

# Appendix 3 – User fee revenues, 2007-2008: comparison between Québec and Ontario

By comparing per capita user fee revenues, we see that Québec collected $887 per capita less than Ontario in 2007-2008. That amounts to $6.8 billion.

## ■ Departments, organizations and networks

For departments, organizations and special funds, Québec collected $60 per capita more than Ontario. In relation to Québec's total population, that represents $464 million.

— More than half the difference stems from fees on licences and registrations. In 2007-2008, a passenger vehicle driver paid $120 per year in licence and registration fees plus $30 for public transit. The same driver in Ontario paid $89.

— The remainder is attributable in particular to activities specific to Québec such as immigration control and the ministère du Revenu.

Regarding the health and education networks, Québec collets $200 per capita less in fees, i.e. $1 538 million for the population as a whole.

Québec is known for having the lowest university tuition fees in Canada, while those in Ontario are among the highest. In 2007-2008, a full-time student in Québec paid $3 691 less than his counterpart in Ontario. That difference amounts to a total of $733 million.

## ■ Electricity

Regarding electricity rates, Québec collects $441 per capita less than Ontario, for a total of almost $3.4 billion in 2007-2008.

— That is attributable notably to higher average rates in Ontario. The average residential rate is 64% higher, while the average commercial rate is 35% higher.

— Accordingly, expressed as cents per kWh, the residential rate is 11.17 cents in Ontario compared with 6.81 cents in Québec. The commercial rate amounts to 9.6 cents in Ontario and 7.1 cents in Québec.

### ■ Daycare services

Turning to daycare services, the difference is calculated compared to the Canadian average, since data for Ontario are not available.

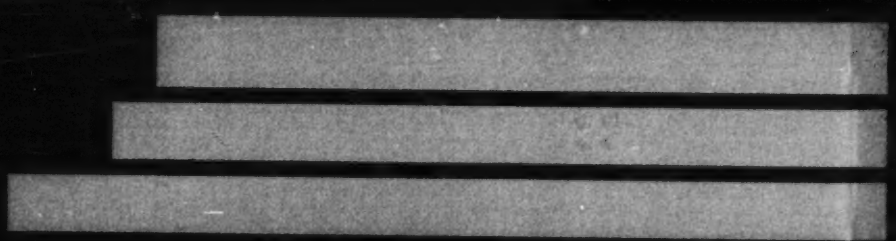
In Québec, parents pay $7 per day for daycare services, while the corresponding amount in the rest of Canada, excluding Ontario, averages $31 per day.

### ■ Insurance

In the insurance sector, occupational health and safety insurance is just about the only field that is comparable to Ontario.

Moreover, unlike the Ontario government, Québec offers parental insurance and automobile insurance.

The Québec and Ontario prescription drug insurance plans are so different that a comparison in terms of fee revenues is inaccurate. In addition, data on premiums, deductibles and co-insurance paid by Ontarians are not available. Without these data, the amount shown in the table corresponds to public spending on prescription drugs in Québec, compared to the corresponding amount in Ontario published by the Canadian Institute for Health Information.



Québec